Bloomberg Markets

MARCH 2015

WHIZ KID

Mac McQuown, a pioneer of index funds, is reinventing the corporate bond. Is he solving a big problem or creating an even larger one?

+ SPECIAL REPORT: INVESTING IN EMERGING MARKETS


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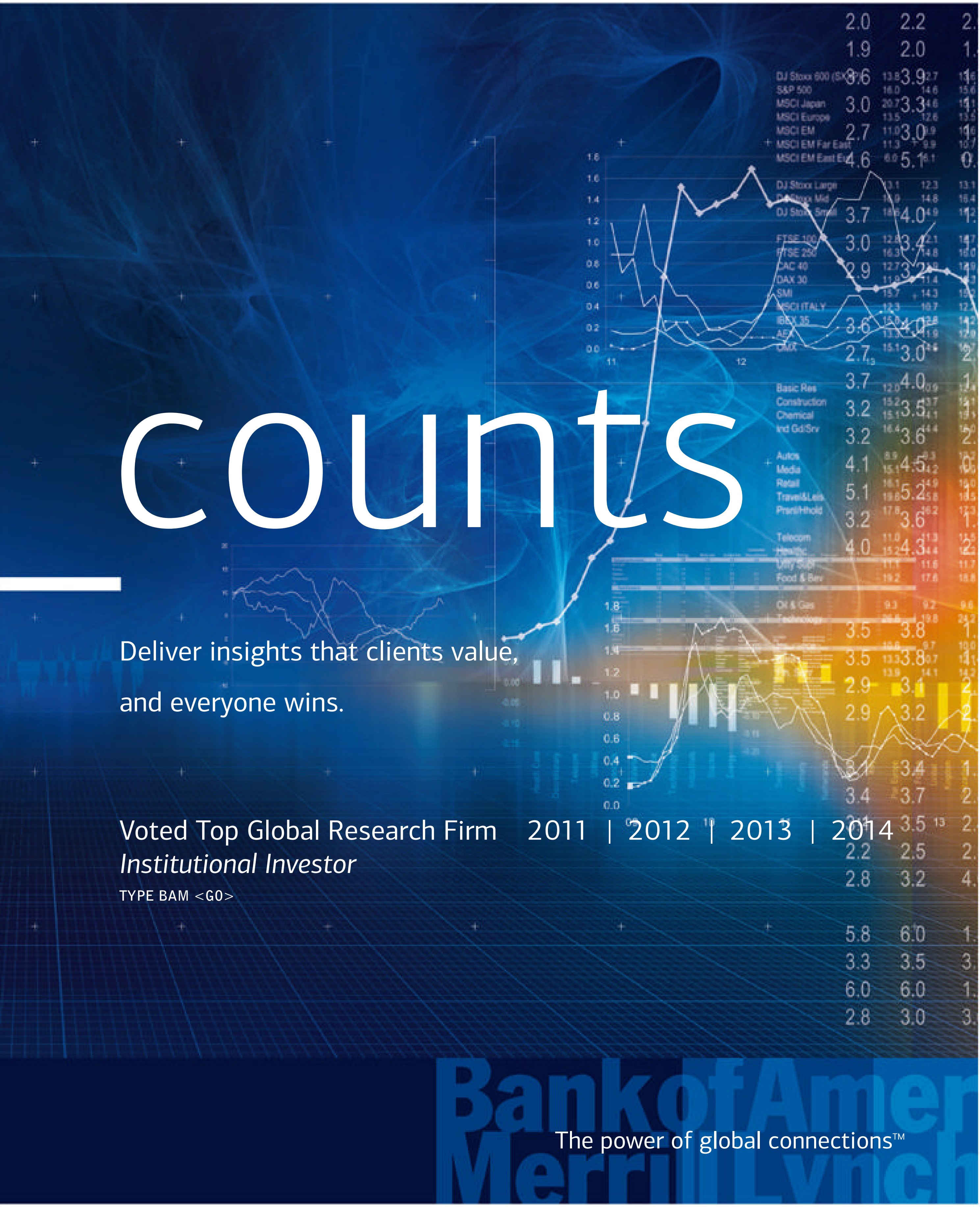
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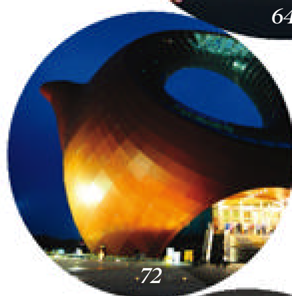
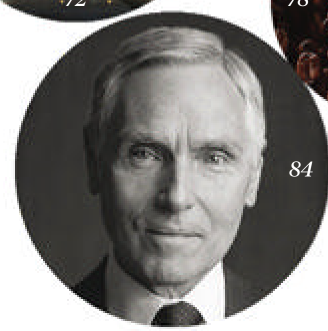
March

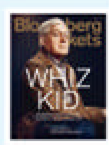
volume 24 / number 03

> ‘Emerging markets’ economic growth rates in general continue to be markedly faster than those of developed markets.’
>
> *Mark Mobius* *page 38*

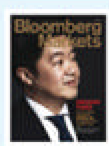




ON THE COVERS



John “Mac” McQuown, photographed Nov. 24 in Sonoma, California
Photograph by **Joe Pugliese**



Michael Kim, photographed Dec. 31 in Seoul
Photograph by **Yoo Young Kyu**

CLOCKWISE FROM TOP: JASON FLORIO; MICHAL CHELBIN; SAM KAPLAN; COURTESY OF SHERBORNE INVESTORS; JI HAIXIN/IMAGINECHINA

March

AGENDA

COMMENTARY

STRATEGIES


92

CLOCKWISE FROM TOP RIGHT: PHOTOS BY: LAYNE GARDNER; BEN HOFFMANN; ILLUSTRATIONS BY: SEAN McCABE; JACOB THOMAS; QUICKHONEY

Editor's View

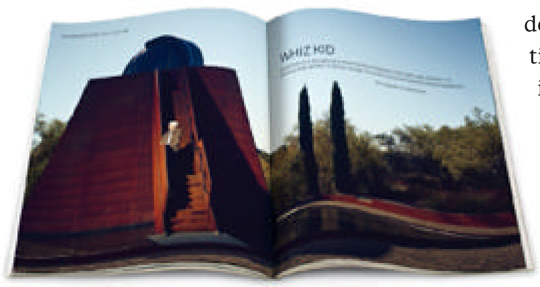
The Bond Engineer

THE FINANCIAL ENGINEERS who created the investment instruments that would play such a toxic role in the global economic crisis gave both finance and engineering a bad name. The credit-default swap, originally designed as a kind of insurance for bank loans, mutated into a monster that aggravated risk instead of mitigating it—impelling, among other things, a $182 billion bailout of American International Group Inc. by the U.S. government.

> 'We've finally figured out a way to make a bond default-free,' says innovator Mac McQuown.

Well, the CDS is back, and this time, as Edward Robinson reports, financial innovator John "Mac" McQuown plans to embed it inside a corporate bond ("WHIZ KID," page 26). Why would he want to do such a thing?

McQuown, still spry and restless at age 80, is an actual engineer (he has a degree in mechanical engineering from Northwestern University) who pioneered the stock index fund. McQuown is now out to ease what he and many others say is a coming liquidity crunch in the $8 trillion U.S. corporate bond market. Enticed by low interest rates, companies have issued record amounts of debt. At the same time, new capital regulations have prompted banks to reduce the inventories of corporate bonds that will be necessary to make the market work smoothly once interest rates start to rise.



McQuown, the inveterate tinkerer, says he can fix that by putting a CDS inside a bond, a move that's been made possible by regulatory changes that will force most swaps to be traded on exchanges and guaranteed by clearinghouses. "We've finally figured out a way to make a bond default-free," McQuown says. Others aren't so sure. John Bogle, the former head of Vanguard Group Inc., labels McQuown a "genius." "But geniuses pursue complexity," he adds—a reminder that financial engineering that's designed to solve a problem can sometimes make it worse.

Ron Henkoff

EXECUTIVE EDITOR

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Letters

UPDATE

Crisis in the Currency Casino

FXCM Inc. has learned firsthand the dangers of leverage in the foreign-exchange markets. Since *Bloomberg Markets*' "The Currency Casino" (December 2014) showed how companies lure investors into risky forex trading by letting them put down as little as 2 percent, the largest U.S. retail forex broker has imploded—itself a victim of too much leverage. On Jan. 15, New York–based FXCM announced that customers' losses exceeded their margin deposits by $225 million in a single day, after Switzerland unexpectedly removed the trading-range cap on its currency. The franc soared 41 percent against the euro, forcing several brokers to shut when their customers' margin accounts swung into the red. FXCM, a subject of our story, saw its shares plummet 92 percent the next day before trading was halted. Leucadia National Corp., the parent of investment bank Jefferies Group LLC, agreed to extend a lifeline in the form of a $300 million, two-year loan with a 10 percent interest rate that can rise to 17 percent.

Our story reported that U.S. retail forex brokers entice customers with leverage as high as 50:1. Most investors lose money in the lightly regulated industry; some have their entire investment wiped out in minutes. For brokers, the higher the leverage they offer, the narrower their margin of protection should customer bets go bad. At FXCM, 50:1 leverage, or a 2 percent margin on the underlying currency, could stick it with an 18 percent loss if a currency moved against a customer by 20 percent. After our story, the Commodity Futures Trading Commission said it planned to bar investors from using credit cards to pay for trades made with retail currency brokers starting on Jan. 31. And CFTC Commissioner Sharon Bowen called for tighter regulations to protect consumers. FXCM didn't respond to calls or e-mails seeking comment.

DAVID EVANS

Correction

"The Quants on the Left Bank" (February 2015) contained incorrect information on Marc Potters and Jacques Sauliere, co–chief executive officers of Capital Fund Management. Potters was born in Belgium and is a naturalized citizen of Canada; Sauliere has an engineering background and an MBA from France's Insead.

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Michael R. Bloomberg

CHAIRMAN
Peter T. Grauer

Bloomberg Markets

PUBLISHER
Michael Dukmejian
212-617-2653

ADVERTISING SALES DIRECTOR, AMERICAS
Chris Kurtz 212-617-3087

ADVERTISING SALES DIRECTOR, EMEA
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AGENDA

Oil Spillover

As the collapse in prices wreaks havoc on producers, the pain is spreading to bondholders, shareholders and banks.

IN MAY, a small oil producer called Energy XXI (Bermuda) Ltd. sold $650 million in bonds. Less than a year later, after the biggest oil market rout since the Great Recession, those bonds are trading below 50 cents on the dollar. Although the Houston-based company is one of the lesser-known players in the U.S. drilling boom, its capital markets crackup shows how quickly the effects of falling crude prices are spreading.

Energy XXI and dozens of independent drillers like it racked up billions of dollars in debt in recent years as investors poured money into energy companies, helping boost U.S. oil output—and create a global supply glut. Bondholders, shareholders and banks are now facing losses. What happens in the oil patch doesn't stay in the oil patch.

Michael Shaoul, who helps oversee about $9 billion as chief executive officer of Marketfield Asset Management in New York, says oil-related losses are going to show up in surprising places. "So much of this has ended up in 401(k)s and

in pension funds and in mutual funds, and that's where the bulk of the pain is going to be felt," Shaoul says. "It will be more people's problem than they realize."

Oil and gas producers raised $550 billion in new bonds and loans in the past five years, according to a December report from Deutsche Bank AG. They attracted stock investors, too: Energy-focused mutual funds and exchange-traded products had record inflows last year, pushing total assets in that category to $109.9 billion as of November, according to research firm Strategic Insight.

To get a sense of how crashing crude prices can become a problem for more people, consider that Energy XXI's second-largest shareholder is Vanguard Group Inc., which holds the stock through more than a dozen funds that are included in the portfolios of insurance companies and in popular investment products.

Continental Resources Inc., a fracking pioneer and the largest operator in North Dakota's Bakken shale, provides another example of how the pain can spread. Founder Harold Hamm in January asked a court to reduce a $975 million alimony payment on the grounds that his fortune, comprised largely of Continental shares, had been cut nearly in half since November as crude plunged. Schadenfreude aside, the largest Continental shareholder after Hamm and his family is Fidelity Investments, whose funds are a mainstay of many Americans' retirement savings.

Flush with other people's money, many drillers spent far more than they made in recent years—and plugged the shortfall with debt. Energy XXI, which dropped Bermuda from its name in November, has bought assets throughout the Gulf of Mexico, spending $1 billion for Exxon Mobil Corp. properties in 2010 and another $2.5 billion for EPL Oil & Gas Inc. last year. The company in the past two years has reported cost overruns that, along with oil prices, have hurt its shares.

Founded 10 years ago by John Schiller Jr., an oil industry veteran who was once vice president for exploration and development at Devon Energy Corp., Energy XXI has borrowed from banks in Australia, Canada, Scotland, Spain and Japan. Such a varied roster of lenders is typical for the small drilling companies that have led the U.S. oil production renaissance.

'THERE WILL BE BLOOD AT BANKS WITH LEVERAGED LOANS TO EXPLORATION AND PRODUCTION COMPANIES.'

JEFF BAHL

Energy XXI didn't return calls and e-mails seeking comment. In an interview in December, Greg Smith, a spokesman, said the company has plenty of liquidity. "We think the sell-off has been a little overdone," Smith said. Energy XXI's shares fell 88 percent in the six months through mid-January.

Oil producers and oilfield service companies have seen their bonds slide as investors lose confidence they will be repaid. Debt of companies such as Chaparral Energy Inc., Comstock Resources Inc., Goodrich Petroleum Corp., Halcon Resources Corp., Penn Virginia Corp., Quicksilver Resources Inc., Sandridge Energy Inc. and Swift Energy Co. were trading at distressed levels as of mid-January, meaning their yields were more than 10 percentage points above U.S. Treasuries.

Lenders—especially regional banks in oil-rich states—are feeling pressure as well. BOK Financial Corp., Cullen/Frost Bankers Inc., Hancock Holding Co., Comerica Bank and Amegy Bank of Texas, a Zions Bancorp subsidiary, each held from $1.6 billion to $3.4 billion in loans to energy producers as of Sept. 30, Fitch Ratings said in a December report. Comerica, Amegy and Hancock are among Energy XXI lenders, along with Commonwealth Bank of Australia; Bank of Nova Scotia; Banco Santander SA, Spain's biggest bank; and Japanese bank Sumitomo Mitsui Financial Group Inc. Hancock Holding declined 27 percent in the two months through mid-January, BOK Financial fell 21 percent, Comerica dropped 16 percent, and Zions slid 15 percent. Representatives of the banks declined to comment on the performance of specific energy loans.

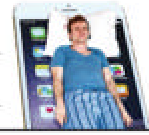
"There will be blood at banks with leveraged loans to exploration and production firms," says Jeff Bahl, who helps oversee $7.7 billion at Cincinnati-based investment advisor Bahl & Gaynor Inc., including shares of Cullen/Frost and BOK Financial.

And banks that are bleeding will be less likely to lend more money in the oil patch—just when drillers need it most. With revenue tumbling along with prices, credit is a vital source of money for cash-strapped oil companies trying to avoid a downward spiral.

ASJYLYN LODER AND ELIZABETH DEXHEIMER

ILLUSTRATION BY QUICKHONEY

31%



Percentage of Americans who would rather forgo sex for a year than give up their smartphone
Source: Boston Consulting

Stagnation Nation

GDP climbed to 5 percent in the third quarter in the U.S., but that didn't end the debate over the possibility the country is stuck in an era of subpar growth.

ECONOMISTS CALL A prolonged period of slow growth or no growth "secular stagnation." At the American Economic Association meeting in Boston in January, Larry Summers and Gregory Mankiw, both former White House advisers and both now Harvard professors, debated whether we're stuck in it.

STAGNATION

"We are recovered only on a definition that revises down what it means to be recovered. [Economic output] is now about 10 percent below potential as it was estimated in 2007. Insofar as the output gap has closed, it is not because we have gotten closer to what we previously thought potential was; it is because we have revised downward our assessment of what the economy's potential is. That 10 percent of potential represents about $20,000 per American family."

One might expect Summers would talk up the current state of affairs, since he helped set President Barack Obama's economic agenda. Instead, it was Mankiw, who worked for Mitt Romney, Obama's opponent in the 2012 presidential race, who lauded the recovery.

NORMALCY

"I think we're returning to more of a normal economy. I think the discussion of secular stagnation is probably going to end at this AEA meeting. I don't think we're going to have another session next year on it. But maybe I'm wrong."

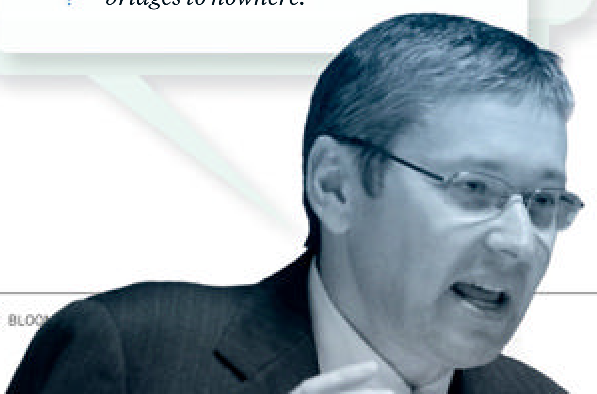
AIRPORTS

"If a moment when we can borrow money, in a currency we print ourselves, for the long-term, below 2¼ percent, and a moment when the construction unemployment rate approaches double digits is not the moment to fix Kennedy Airport, I don't know when that moment will ever come."

Summers says one of the things that should be done to battle stagnant economic demand is more public investment in infrastructure. Mankiw isn't so sure.

BRIDGES

"I'm nervous about infrastructure spending because I think government is not particularly good at doing cost-benefit analysis. We want to make sure we get the right infrastructure spending and not bridges to nowhere."



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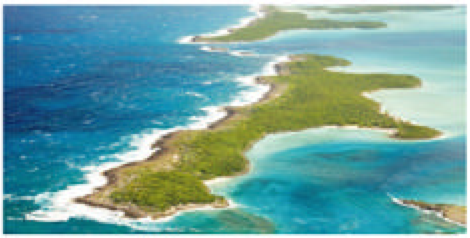

EXUMA CAYS, BAHAMAS

75 acre private island located in the heart of Exuma Cays. Lignum Vitae Cay is one of the most stunning natural Cays with unspoilt beaches, lush vegetation and breathtaking views. WEB: C9XJXD. **$14,000,000** US. Mark.Hussey@SothebysRealty.com

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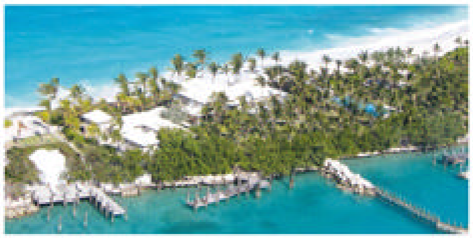

PARADISE ISLAND, BAHAMAS

Private 3.75 acre sea-to-sea estate. 1,750' of waterfront. 6,000 sf main house plus a 2 BR guest house overlooking the beach. Pool and dock. Life is less taxing offshore. WEB: 8T6FKS. **$11,800,000** US. George.Damianos@SothebysRealty.com

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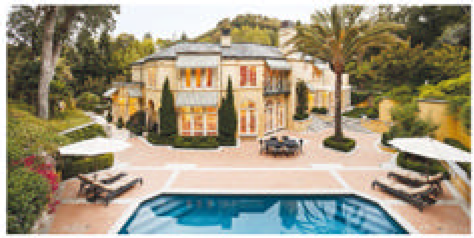

ROSS, CA

This 6 BR, 6 and one half bath villa sits on an approximately flat acre. A coveted location that is close to town, the Lagunitas Tennis Club, and Ross and Branson Schools. **$11,950,000.** Isobel Wiener and Danielle Chavanon.

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SONOMA, CA

11,800± sf home with 6 BR, lake, beach, tennis court and manager's building. 140± acre wine country ranch with 70± potentially plantable acres. 15 minutes to Plaza, 60 minutes to San Francisco. Price upon request. Donald Van de Mark.

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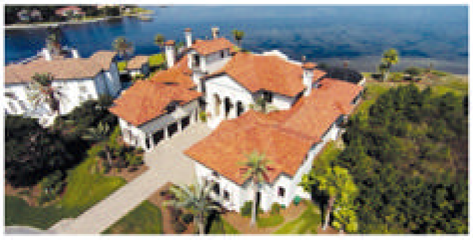

DESTIN, FL

This Tuscan-style home presides over 425' of waterfront from a 1.8 acre site within a gated community with Fred Couples 18-hole course. Two garages accommodate 9 cars. A screened lanai features a zero entry pool. **$4,975,000.** Blake Morar and Chris Abbott.

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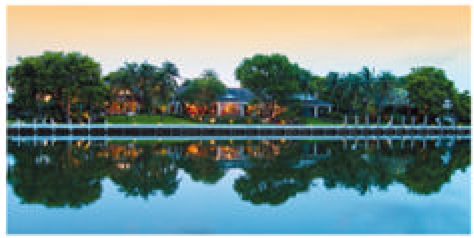

KEY LARGO, FL

Sprawling 7,800 sf waterfront home in Ocean Reef situated on 48,400 sf lot with 300' of water frontage, open floor plan with 6 BR, 8.5 baths, great outdoor living with pool, and separate guest house. **$9,500,000.** Russell.Post@sothebysrealty.com

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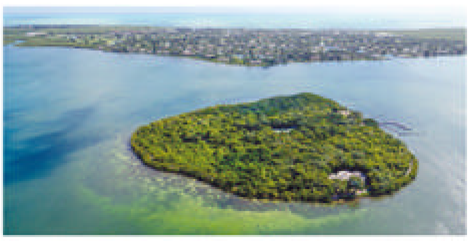

PUMPKIN KEY, FL

Private island 1,000' from shore accommodations in the Ocean Reef community. Self sufficient with water and electric from shore to 12 large bay front lots. Currently, featuring 1 main home, 2 caretaker's cottages and marina. **$110,000,000.**

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KAILUA, HI

Stunning beachfront property on Kailua Beach, rated top 10 beaches in the world. Two homes - total of 7 BR, 6 baths. Just a 20-minute drive from Waikiki and Honolulu. **$12,500,000.** Kala Judd and Mary Worrall.

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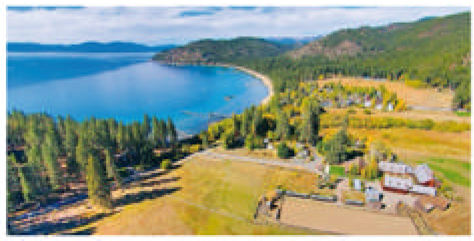

LAKE TAHOE, NV

Boat, ski and golf from this 133 acre historic Tahoe lakefront ranch with pier, entertainment barn, chef's kitchen, 14 guest cabins, indoor pool, gym, office, stables, garden, rodeo grounds, iconic mountain and sandy shoreline. Price upon request.

Sierra Sotheby's International Realty
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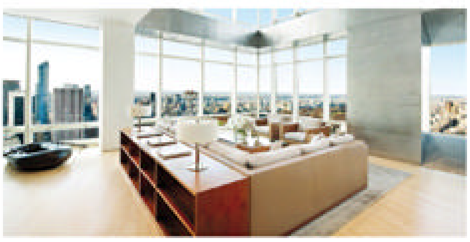

NEW YORK, NY

Spectacular One Beacon Court Penthouse. This 9,000± sf duplex features coveted western outlooks towards Central Park & sunlight from every room. WEB: 0019875. **$82,000,000.** Serena Boardman.

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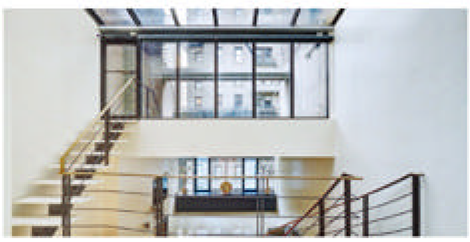

NEW YORK, NY

107 East 61st Street. Spectacular 10,000± sf carriage house with a two-car garage, elevator, pool, large gym, full floor master suite & a rooftop sundeck. WEB: 0019863. **$29,000,000.** J. Roger Erickson.

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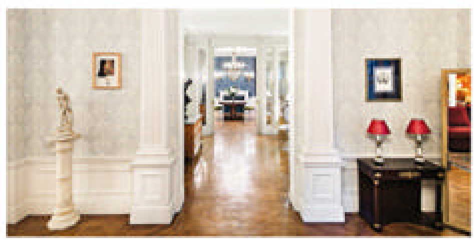

NEW YORK, NY

Park Avenue Magnificence. This enchanting 4 BR, 5 bath duplex maisonette is a one-of-a kind residence filled with charm, grandeur & Old World elegance. WEB: 0019862. **$12,500,000.** A. Schuster.

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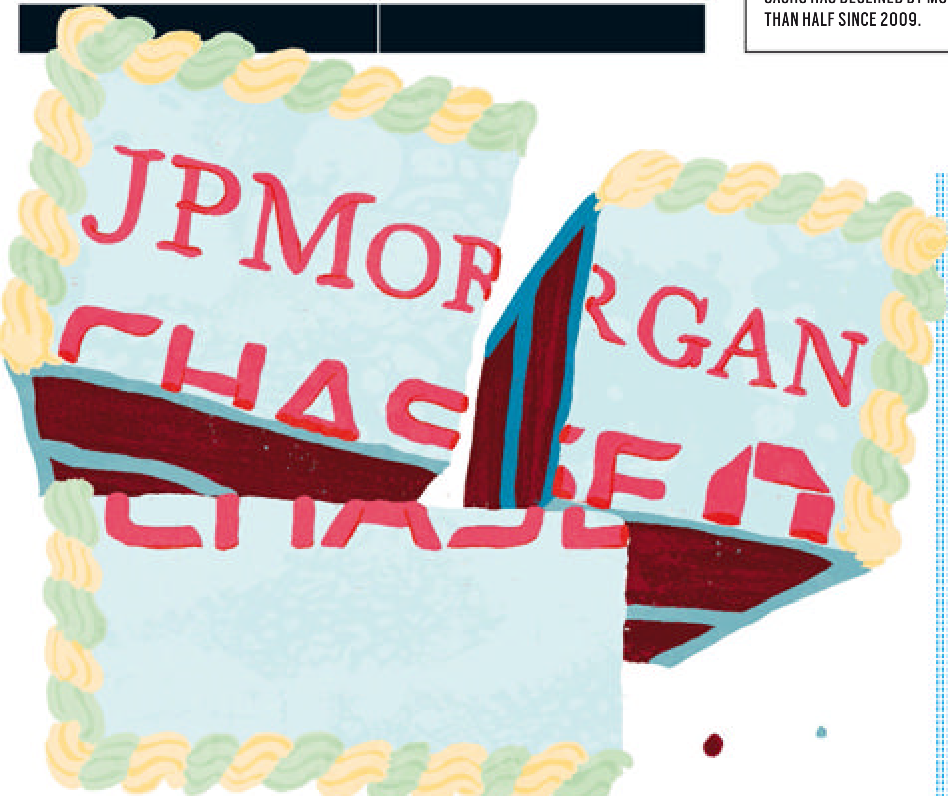
REVVING DOWN

TRADING REVENUE AT GOLDMAN SACHS HAS DECLINED BY MORE THAN HALF SINCE 2009.

Source: Bloomberg

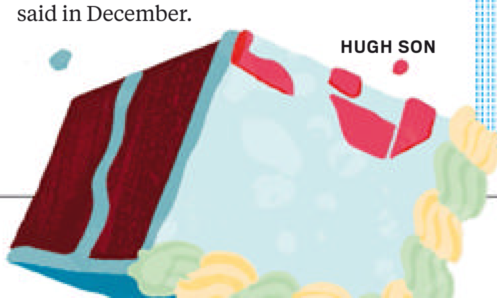


Pushing for Pieces

If Goldman Sachs has its way, JPMorgan—the world's biggest investment bank—would get sliced up.

COULD JPMORGAN Chase & Co.'s parts be worth more to investors than the firm as a whole? Analysts at Goldman Sachs Group Inc. think so. In a Jan. 5 research note, a team of analysts there concluded that JPMorgan—whose size would subject it to stricter capital requirements proposed by the U.S. Federal Reserve—could unlock value by splitting its four main businesses or dividing into consumer and institutional companies. "JPMorgan—and other money centers—would strongly consider strategic alternatives, providing shareholders with a breakup 'put option' if capital requirements get tougher," the analysts wrote. Chief Executive Officer Jamie Dimon wasn't too thrilled by the prospect. "We think that we can earn a superior return, still, versus other banks and carry the higher capital and modify our business model over time without taking drastic action," he said a few days later. Dimon, of course, practically invented the U.S. banking-conglomerate model when he and former mentor Sanford "Sandy" Weill formed Citigroup Inc. to provide virtually any financial service that customers need. Yet even Dimon conceded that he'd ultimately be bound by the wishes of U.S. regulators in the event that they push to split up JPMorgan. Across the pond, one of Dimon's peers seems to already have had a change of heart about the size of today's financial institutions. "The universal-banking model is dead," Barclays Plc Chief Executive Officer Antony Jenkins said in December.

HUGH SON

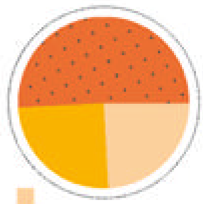


Bloomberg Global Poll

WHAT'S HOT ... AND NOT

Investors are bullish on the U.S. Russia and the EU? Not so much.

WHERE DO YOU PREDICT THE S&P 500 INDEX WILL BE SIX MONTHS FROM NOW?

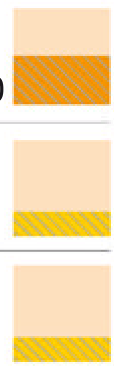


Higher 51%

Lower 25%

Little change/ Not sure 24%

WHAT ARE THE WORST MARKETS FOR INVESTORS IN THE YEAR AHEAD?



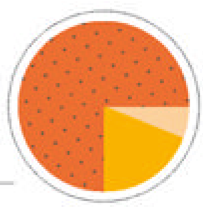
Russia 51%*

European Union 25%*

Brazil 25%*

Respondents could give more than one answer.

HOW DO YOU FEEL ABOUT THE PLUNGING PRICE OF OIL FOR THE WORLD ECONOMY?



It's mostly positive 75%

It's mostly negative 19%

I'm not sure 6%

The poll, conducted from Jan. 14 to 15 by Selzer & Co., sampled the opinions of 481 traders, bankers and money managers who subscribe to the Bloomberg Professional service. The margin of error is plus or minus 4.5 percentage points.

ILLUSTRATION BY JACOB THOMAS

'THEY HAVE A COLLECTIVE PH.D. IN ECONOMICS, AND ALL OF THEM ARE WEAK.' *— Author Dennis Gartman, describing the worrying accuracy of* ***zinc****, copper, tin and aluminum in predicting slower growth*

Lei Jun is assembling a constellation of startups.

China's Big Bang

Can Xiaomi, the world's fastest-growing smartphone maker, create a universe more expansive than Apple's or Samsung's?

IN 2014, just three years after releasing its smartphone, the Mi, Xiaomi Corp. overtook Apple Inc. and Samsung Electronics Co. in China sales. The Beijing-based company already ranks No. 3 in sales globally.

Now, co-founder Lei Jun is on a buying spree to move beyond handsets—and, he says, build a bigger brand than his rivals within a decade.

During the past few months, Xiaomi participated in investments valued at more than $600 million in established companies and announced that it has taken undisclosed stakes in 25 startups, which make everything from an air purifier to low-energy light bulbs. "Xiaomi is looking to dominate the next big technology cycle after smartphones: the Internet of things," says Cyrus Mewawalla, managing director of London-based CM Research Ltd.

Those investments include 21Vianet Group Inc., an Internet data center services provider, and Misfit Wearables Corp., maker of the Shine activity-and-sleep tracker. "Investing in startups will allow us to build other types of hardware without doing all of the design and development," says Bin Lin, Xiaomi's president.

In December, Xiaomi raised $1.1 billion from investors, including Mail.ru Group Ltd. founder Yuri Milner. Lei has said the company is valued at $45 billion after its revenue doubled to $12 billion last year.

Xiaomi's push has credibility because of its software roots. The company began by developing an adaptation of Google Inc.'s Android operating system called MIUI, which now has more than 85 million users worldwide. "Most other Android players are not software companies; they have hardware DNA," says James Roy, a Shanghai-based analyst at China Market Research Group. "Xiaomi seems to be different." **EDMOND LOCOCO**

NETTING A PROFIT

RUSSIAN BILLIONAIRE MIKHAIL PROKHOROV COULD MAKE BANK IN BROOKLYN.

THE BROOKLYN NETS may have a losing NBA record, but they'll likely prove to be a winning investment for Mikhail Prokhorov, below. The commodities tycoon, who owns 80 percent of the club, is exploring a potential sale.

$220 MILLION What Prokhorov paid for the team (and a 45 percent stake in the Barclays Center arena, which isn't for sale) in 2010

$144 MILLION What the team lost in the 2013–14 season, according to ESPN's Grantland

$780 MILLION Amount the Nets were worth in early 2014

$2 BILLION What Steve Ballmer paid for the Los Angeles Clippers last year, boosting valuations for professional sports teams.

$1.3 BILLION Approximately how much the Nets are worth, according to Peter Schwartz, a valuations expert at Christie & Associates

$10.8 BILLION Prokhorov's net worth as of Jan. 14, down from a high of $12.5 billion in November. Collectively, the eight Russians richer than Prokhorov have lost about $12 billion since then.

SCOTT SOSHNICK

JESSE D. GARRABRANT/NBAE VIA GETTY IMAGES; OLEG NIKISHIN/EPSILON/GETTY IMAGES (PROKHOROV)

ILLUSTRATION BY SEAN McCABE

$48.3 BILLION Amount venture capitalists pumped into U.S. startups in 2014, the most since 2000's $105 billion

Sources: National Venture Capital Association, PricewaterhouseCoopers

High-Flying Investments

Fueled by surging demand, the market for racing pigeons has taken off.

TO MOST CITY DWELLERS, pigeons are vermin to be shooed from park benches and warned off window ledges with spikes. Gourmands might contend that the spatchcocked squabs can make a nice Sunday lunch. But pay more than 100,000 euros for a pigeon?

It's becoming increasingly common, driven largely by interest in pigeon racing among China's newly rich. In May 2013, Chinese businessman Gao Fuxin set a new record, paying €310,000 ($391,000) in an online auction for a pigeon named Bolt, after Jamaican sprinter Usain Bolt. The previous record: €250,400, paid by a Chinese shipping tycoon in 2012.

"The Chinese, they care a lot about their face, and they are willing to spend a lot of money to get that face—to show off," says Ian Somers of Pigeon Paradise, the Belgium-based broker that sold Bolt. (Birds from Belgium and the Netherlands are prized for their countries' racing traditions.) The company has conducted nine auctions since 2009 in which the total proceeds exceeded €1 million.

In a typical pigeon race, hundreds of birds from different breeders' lofts are outfitted with time-keeping bands, trucked to a starting point hundreds of kilometers away (the exact distance home varies for each bird) and then released simultaneously. The winning bird isn't the one that

In Belgium, a scandal erupted in 2013 when six pigeons tested positive for banned performance-enhancing drugs, including cocaine and painkillers.

According to pigeon lore, birds with whiter irises are better racers and those with larger pupils excel at short distances.

gets back to its home loft first but rather the one that travels at the fastest average speed.

Purses can exceed €1 million, and many races in China also feature an active illegal betting scene. More than €2.5 million can ride on a race's outcome.

Owners anticipate that at least 10 percent of their entrants won't make it back in each race. Hawks are a common problem. So are thieves. In China and Taiwan, so-called pigeon pirates wait along the birds' expected routes with bait and nets. If captured, the birds are resold or ransomed. Expensive birds such as Bolt are simply too valuable to race. They're put out to stud after being auctioned.

"In pigeon racing, blood is everything," says Mike Ganus, a breeder and racer in Granger, Indiana, who sells about 500 birds a year to China. "If you don't have the genetics, you won't have a winner, no matter what you do."

While buyers are beginning to rely more on the racing record of a pigeon and its offspring instead of physical traits, auction catalogs still feature close-ups of the birds' wing feathers. One bit of pigeon lore holds that the length of a bird's seventh primary feather determines its speed.

"It used to be you could sell any European winner to the Chinese," Ganus says. "Now, they are looking for very exclusive pigeons." **JEREMY KAHN**

LAYNE GARDNER


Invesco
15 YEARS
OF TAKING
INVESTING TO
HEIGHTS ONCE
DEEMED
IMPOSSIBLE.

5.3%

Share of global beer volume controlled by **China's Snow brand**. **Bud Light** and **Budweiser**'s combined total: 4.8%.

Sources: Euromonitor International, Bloomberg

Japan's New Brews

Craft beers flavored with wasabi, figs and green tea make inroads in the land of Kirin and Sapporo.

THE RUBY-HUED Baird Jubilation Ale, flavored with cinnamon twigs and ripe figs candied in Japanese red sugar, tastes spicy and rich, the kind of drink you relish on a cold night. It's one of two dozen intriguing brews being poured at a Japanese beer tasting in New York that show why the country's craft beers are catching the world's attention.

"We're at the dawn of the craft beer era in East Asia," says American expatriate Bryan Baird, who founded his Numazu-based brewery in 2000 with his wife, Sayuri, and is noted for adding distinctly local ingredients to his award-winning brews. "It reminds me of the U.S. 20 years ago."

Baird Brewing Co. is one of more than 200 companies in Japan's vibrant *ji-biru* (craft beer) scene, which is leading the Asian beer revolution that's spread to China, South Korea and Taiwan. Japan's thriving industry arose as a flavorful challenge to the bland, super-dry beverages from behemoths Asahi, Kirin and Sapporo. "Up until 1994, you couldn't get a brewing license unless you made 2 million liters a year," says Mark Meli, author of *Craft Beer in Japan*. "When the law reduced it to 60,000, microbreweries exploded."

Initially, a lot of Japanese craft beers were terrible, Meli says, because few brewers had scientific training. That's changed. The newest brews, though heavily influenced by American trends, seem more subtle and often feature unique twists like aging in sake barrels made of *sugi* wood, fermenting with wild yeasts from Japanese cherry trees and adding flavors such as wasabi and green tea.

Breweries are experimenting with a huge range of styles, from bold IPAs to fruit beers to cask-conditioned ales. Just as distillers did with single-malt whisky, brewers are tweaking other countries' beer recipes. It's another example of the East-West fusion that Japan does so well.

ELIN McCOY

FOUR TO POUR

BAIRD SURUGA BAY IMPERIAL IPA
Baird's long list of ales and interesting fruit beers includes this powerful yet subtle brew with a piney aroma and a citrusy, bitter hop character.

ECHIGO STOUT
The country's first microbrewery makes this dark, deep and satisfying beer that offers sweet hints of chocolate.

HITACHINO NEST RED RICE ALE
Sake producer Kiuchi Brewery is known around the world for its innovative Hitachino beers, including this sweet, fruity one brewed with a Japanese strain of red rice.

OZENO YUKIDOKE IPA
This light, copper-colored India pale ale is one of the best in Japan. It's elegant and complex, with a note of orange peel. E.Mc.

TOP: ISTOCK.COM; BOTTLE CAPS: EM

PHOTOGRAPH BY ERIC HELGAS

Capitalizing on Cuba

The island nation offers myriad opportunities for investment. The only things standing in the way are the Castro brothers and the U.S. Congress.

THE WORLD'S newest emerging market lies just 90 miles off the Florida coast. To get there, however, investors hoping to exploit the normalization of U.S.-Cuba ties will first have to hack through a thicket of socialist regulations—and that can't happen unless President Barack Obama pushes for certain changes.

For a nation of only 11.2 million, Cuba is an extraordinarily appealing market, one that should someday make *Bloomberg Markets*' annual list of the best emerging markets to invest in. (See "Defying the Turmoil," page 38.) Compared with its neighbors, Cuba has high life expectancy and per capita income, and its people are well educated, with 100 percent literacy and a high proportion of the college-age population in university or graduate school. Its plentiful doctors and scientists could make it a hub for medical tourism and pharmaceutical development.

If the U.S. embargo were lifted, U.S. sales to Cuba could rise more than 10-fold, to as much as $6 billion a year. Moreover, it's possible that Cuba's offshore waters hold up to 4.6 billion barrels of oil and nearly 10 trillion cubic feet (280 billion cubic meters) of natural gas. And as the ex-leader in global sugar exports, Cuba could also be an important provider of biofuels.

Right now, though, the Castros still have the economy under lock and key. Halfhearted economic reforms have slowed Cuba's growth. Farmers have been granted the right to cultivate land for 10 years, for instance, but the government can then reclaim it. Foreign investors can have operational control of 50-50 joint ventures, but they must hire and pay workers through the state. Investments in tourism remain tangled in red tape, too. Canadian investors aiming to build a $4 million golf course (after the Cuban government lifted its ban on the bourgeois sport) needed eight years to get their project off the drawing board.

The Obama administration can move to widen these and other fissures in Cuba's cracking socialist edifice. For starters, the U.S. should go ahead and take Cuba off its list of state sponsors of terrorism, not merely review its status. It hasn't belonged there for a long time, and the accompanying sanctions needlessly hinder foreign trade and investment.

The U.S. also has a strong interest in quickly settling the trademark disputes and 6,000 expropriation cases dating back to the 1960s, because these need to be resolved before the embargo can be lifted. People deserve to be compensated, of course, but companies should recognize that their interests are better served by getting access to Cuba's market.

The Obama administration can also start talks with Cuba on a trade and investment framework agreement that would help secure protections for U.S. investors, settle regulatory issues and promote intellectual property rights and technology standards.

The Castros' most die-hard opponents in Congress will resist such initiatives, let alone an end to the embargo. And it's true that Cuban socialism and its repressive apparatus remain largely intact. But isn't it time for those who believe in the transformative power of capitalism to demonstrate the courage of their convictions?

BY THE EDITORS OF BLOOMBERG VIEW
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ILLUSTRATION BY **EDEL RODRIGUEZ**


HOW
DO YOU
look ahead
WHEN YOU'VE
BARELY HAD
A CHANCE
TO LOOK UP?
When you've poured your energy into building a successful business, it's often difficult to imagine what's next. Whether you plan to expand your business or sell it, our team of experienced wealth planners and advisors can assist you with your next move. We can give you access to credit or help manage the proceeds from a sale. Together, we'll create a comprehensive plan so you can move forward with confidence.
ustrust.com/business Life's better when we're connected®

PHOTOGRAPHS BY JOE PUGLIESE

WHIZ KID

FOUR DECADES AGO, MAC McQUOWN REVOLUTIONIZED THE WAY WE INVEST IN STOCKS. NOW, HE AIMS TO UPEND THE $8 TRILLION U.S. CORPORATE BOND MARKET.

BY EDWARD ROBINSON

John "Mac" McQuown

yanks on a chain and hoists open a metal roll-up door with a clang. In a flowery aloha shirt, shorts and sandals, he looks like a retiree with little more on his mind than sipping a mai tai by the pool. But McQuown is actually one of the architects of the modern investing system, and he's far from retiring. "Come here, I want to show you something," he says on a sunny afternoon in California's Sonoma Valley.

He steps inside a workshop filled with band saws and other woodworking tools. A gnarled tree trunk the size of a sofa has been cut down the middle lengthwise, revealing ribbons of grain beneath its bark. "I'm going to make a table out of that," says McQuown, 80, in the down-home cadence of his Midwestern roots.

A mechanical engineer, McQuown likes to make things at Stone Edge Farm, his 16-acre (6.5-hectare) estate nestled between two mountain ranges north of San Francisco. In his metal shop, he machines parts for the natural-gas-fired microturbine he's installed in the compound. Rows of cabernet sauvignon vines hang heavy with ripening purple fruit destined for his winery. He even keeps hundreds of thousands of bees to make his own honey.

Yet what McQuown truly loves to create is something that can't be seen, heard or tasted. He's a financial engineer, a maker of methods and instruments that enable investors to exploit what he likes to call "distortions" in the capital markets. His latest handiwork is a hybrid security that embeds a credit-default swap, the derivative that helped push the global financial system to the edge of ruin in 2008, in a corporate bond.

By joining the two securities into an instrument called an "exchangeable bond," or eBond for short, McQuown says companies will be able to transform junk-graded debt into the equivalent of AAA-rated notes. And he's hoping it will help him take advantage of possibly the biggest imbalance he's seen in a career that stretches back to the dawn of quantitative investing—a looming liquidity crunch in the $8 trillion U.S. corporate bond market. McQuown says reinventing the corporate bond to make it less risky should make it easier to trade.

"The market is bumping into its own boundaries," McQuown says, "and this has created a necessity for solutions."

McQuown is bringing out his "synthetic" instrument as years of near-zero interest rates have thrown the debt market into flux. Since January 2009, corporations have issued $7.2 trillion in U.S. dollar-denominated bonds, a 39 percent jump over the prior six years. Meanwhile, new U.S. and international capital requirements have forced JPMorgan Chase & Co., Bank of America Corp. and other banks to reduce the risks on their books. Wall Street's primary dealers used to stockpile bonds so they could instantly match buyers and sellers. Now, they've whacked their supplies of fixed-income securities by 76 percent, to $55 billion as of Jan. 5 from about $250 billion in 2007. The result: an unprecedented gap between outstanding bonds and available liquidity in the world's No. 1 source of capital for corporations.

> 'THE MARKET IS BUMPING INTO ITS OWN BOUNDARIES, AND THIS HAS CREATED A NECESSITY FOR SOLUTIONS,'
> EBOND CO-CREATOR MAC McQUOWN SAYS.

"That's dangerous," says Daniel Gallagher, a commissioner with the U.S. Securities and Exchange Commission. "We've had this long bull run in the bond market, but what happens when interest rates rise and there's more pressure to sell than to buy? Liquidity could dry up, and that could make it harder and more expensive for companies to issue new bonds, and that could impact the broader economy."

The eBond joins a wave of exotic new securities that are hitting the capital markets seven years after the crash. Intercontinental Exchange, or ICE, in Atlanta, for example, has introduced futures based on CDS indexes. And Amundi SA, a Paris-based asset management firm, is one of many companies plying investors with automated "smart beta" exchange-traded funds designed to beat the market with little or no increase in fees.

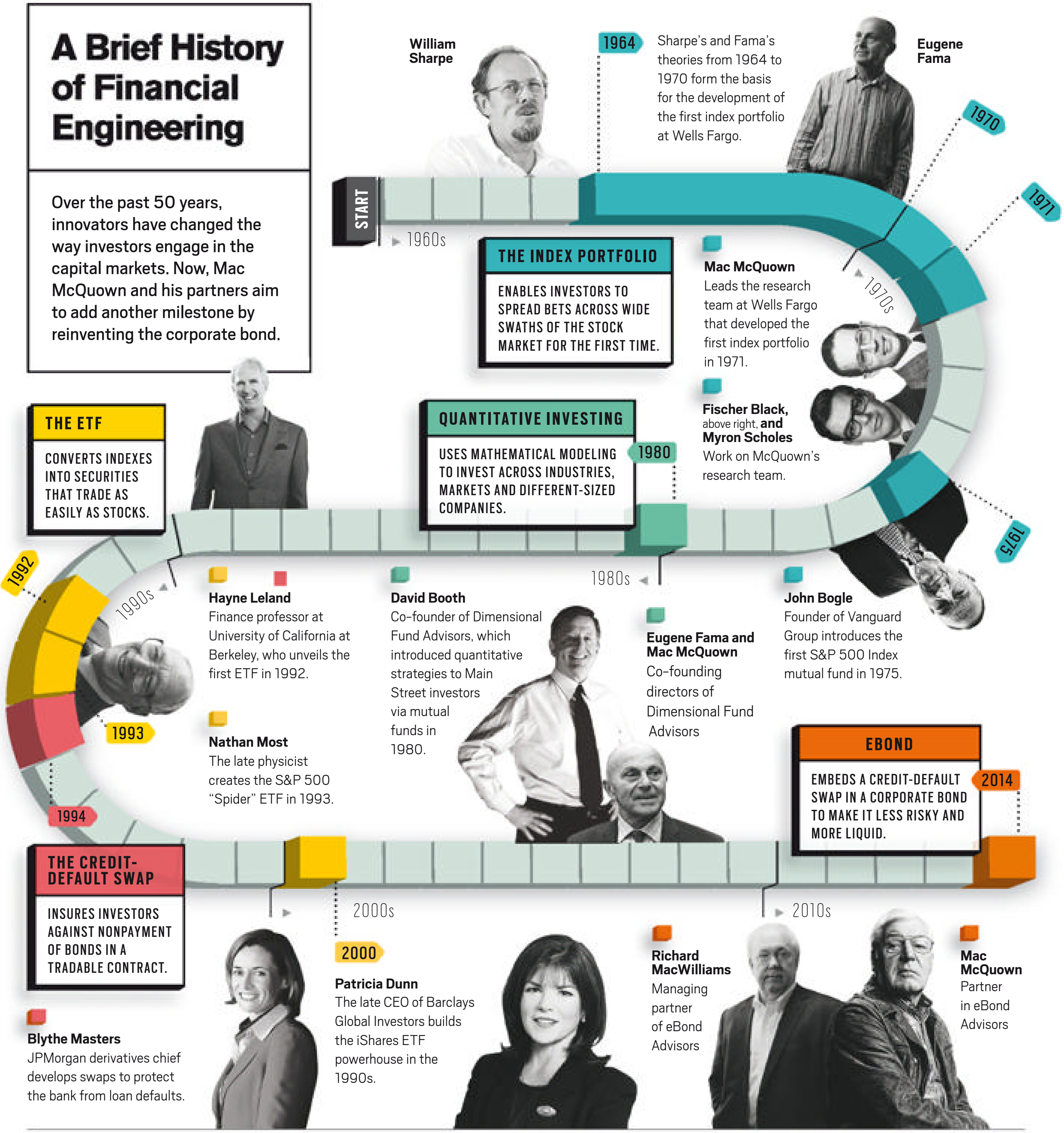
"There's a lot of action, a lot of experimentation, in the market now," says Josh Galper, the managing principal of Finadium LLC, a finance research firm based in Concord, Massachusetts. "But innovation does not always reduce risk—it just moves it around."

McQuown says his eBond will enable investors to jettison their credit risk because the swap, which is essentially a form of insurance, will cover their losses should the debtor fail. To garner such protection now, an investor must purchase a swap separately to cover a bond. "We've finally figured out a way to make a bond default-free," says McQuown, a partner at eBond Advisors LLC, a New York–based firm that's producing the new security.

The newfangled instrument, which McQuown developed with fixed-income entrepreneur Richard MacWilliams, has won the support of influential figures in finance. Nobel Memorial Prize–winning economist Robert Merton and former BlackRock Inc. Vice Chairman Blake Grossman are among the investors in

Previous spread: Fascinated by astronomy, **Mac McQuown** built an observatory on his farm.

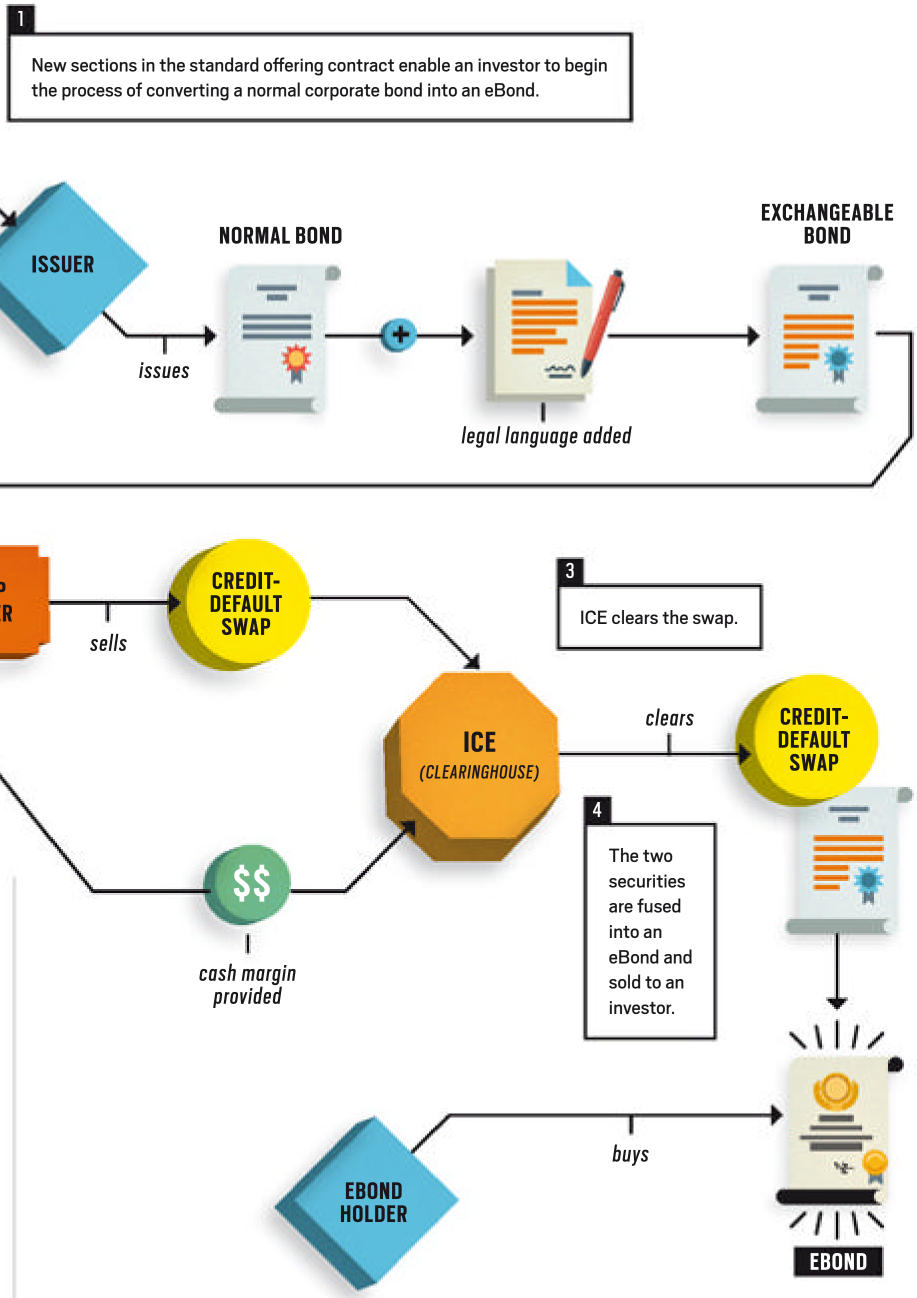
OPPOSITE, START TO FINISH: AP PHOTO; JEFF SCIORTINO/CORBIS; COURTESY OF MIT MUSEUM (2); STEFFEN THALEMANN/CORBIS;COURTESY OF UNIVERSITY OF CALIFORNIA, BERKELEY; ANDREW STAWICKI/GETTY IMAGES; MOJGAN AZIMI/BLOOMBERG NEWS: AP PHOTO/M. SPENCER GREEN; PASCAL PERICH/CORBIS; HEWLETT-PACKARD CO./VIA BLOOMBERG NEWS; ADAM KRAUSE; JOE PUGLIESE



eBond Advisors. And John Reed, the one-time chairman of Citigroup Inc. and the board of trustees at the Massachusetts Institute of Technology, is an adviser to the firm. "It's an important idea that deserves to get off the ground," says David Booth, co-founder and co-CEO of Dimensional Fund Advisors, an Austin, Texas–based investment firm with $381 billion in assets and another backer of the venture. "The way bonds trade now is abysmal, and if we can make the bond market as liquid and

The Making of an eBond

By fusing a corporate bond with a credit-default swap, the hybrid security aims to eliminate the risk borne by investors.



transparent as the stock market, that's a socially desirable outcome."

The eBond evokes a long line of inventions that were supposed to tame the markets but instead wrought havoc. In 1998, hedge fund Long-Term Capital Management needed a $3.6 billion bailout from 14 global banks after its mathematical models for government bond arbitrage blew up following Russia's default. Ten years later, a raft of mortgage-backed securities meant to neutralize risk crashed much of the world's economy. John Bogle, the founder of index mutual fund pioneer Vanguard Group Inc. and a champion of no-nonsense investing, has crossed paths with many financial engineers, including McQuown. He's as skeptical as ever that their work yields lasting benefits for investors. "I liked McQuown, and he's probably a genius—I have no problem saying that," Bogle, 85, says. "But geniuses pursue complexity. Any innovation in the financial field is likely to fail. Most are designed to enrich the sellers and impoverish the buyers."

Yet McQuown isn't an alchemist who made his name cooking up toxic securities. He actually shares Bogle's passion for open, cost-efficient markets. Forty-four years ago, McQuown applied the theories of economists William Sharpe, Eugene Fama, Fischer Black and Myron Scholes to invent the first equities index portfolio. The breakthrough helped usher in the era of passive investment in an array of stocks across the market, now the linchpin in many a 401(k) fund. Sharpe, Fama and Scholes were eventually awarded Nobel Memorial Prizes for their work; Black died before he could be honored.

In the 1990s, McQuown and two partners devised a way to use a company's

stock price to predict how likely it was to default on its debts. The analytical tool, which the trio sold to Moody's Corp. in 2002 for $220 million, is a fixture on trading floors worldwide. Today, McQuown is a partner in DCI, a $5 billion fixed-income hedge fund in San Francisco.

"Mac's one of those guys who's been very influential behind the scenes," says Booth, a billionaire who donated $300 million to what became the University of Chicago Booth School of Business in 2008. "To bring about fundamental change, you need great thinkers and researchers, but you also need implementers. People like Mac don't win Nobel Prizes; they implement the ideas of the guys who do. He's a catalyst."

Now McQuown and MacWilliams, eBond Advisors' managing partner, are betting they can move a market that has proved impervious to change. For the past 25 years, the two men have watched as equities trading has become as easy and accessible as online shopping. When it comes to bonds, little has changed since the days when Michael Lewis played liar's poker with his pals at Salomon Brothers in the 1980s. Eight out of 10 deals are still executed by two traders on the phone, according to Greenwich Associates, a research firm in Stamford, Connecticut. Wall Street's top 10 banks still control 90 percent of trading in corporate bonds. And the market is still fragmented into tens of thousands of bond issues because a single company can sell scores of unique notes with varying maturities and interest rates.

"We've had a transparent equity market since it began, but we still don't have a transparent debt market," McQuown says. "Instead, we have all these bilateral arrangements with highly levered and highly volatile dealers. There's no reason in the world why corporate bonds shouldn't trade like equities."

For entrepreneurs and market stalwarts alike, such structural flaws aren't a worry; they're an opportunity. BlackRock, the No. 1 global investment firm, with $4.3 trillion in assets, has formed a strategic alliance with MarketAxess Holdings Inc. to offer investors an alternative to what it calls a "broken market." New York–based Electronifie Inc. is one of several startups coming online to help investors bypass banks and find liquidity in "dark pools," which are private exchanges used to trade stocks.

Banks, too, are joining the push. Late last year, Goldman Sachs Group Inc., Credit Suisse Group AG and 10 of their rivals allied with more than a dozen investment firms to form a global trading network dubbed Project Neptune. (Bloomberg LP, the parent of Bloomberg News, also operates an electronic trading platform for fixed-income securities.)

"Investors have been building larger and larger positions of credit exposure in their portfolios, and they're going to need alternative ways to exit them," says Richard McVey, chief executive officer of MarketAxess, the No. 1 digital hub for corporate bonds in the U.S. "This is a massive capital markets problem, and it needs to be solved."

McQuown, still spry, with a mop of snowy hair, a California tan and a kung-fu grip of a handshake, isn't interested in starting an electronic trading platform. He and MacWilliams have set out to reinvent the bond itself. Peter Aherne, head of

Bryan Jennings, below left, and **Richard MacWilliams** are on McQuown's eBond Advisors team.

PHOTOGRAPHS BY **ADAM KRAUSE**

North America capital markets, syndicate and new products at Citigroup, agrees that the eBond could be a breakthrough. "By linking credit protection and a bond in a single security, I would expect there to be portfolio benefits in terms of risk management and trading opportunities," Aherne says. "More buyers for these securities should enhance the liquidity of the bonds."

But as McQuown and MacWilliams introduce their new product, they may find fund managers underwhelmed by the idea of a riskless corporate bond. "The way we make money for our clients is by assessing risk and generating risk-adjusted returns, and if you have a security that hedges that risk premium away, then why is it compelling? I would just buy Treasuries," says Bonnie Baha, the head of global developed credit at DoubleLine Capital, a Los Angeles firm that manages about $56 billion in fixed-income assets. "This product sounds like a great idea in theory, but in practice it may be a solution in search of a problem."

And, of course, fusing a security as straightforward as a bond with the notorious credit-default swap does ring a lot of alarms, says Phil Angelides, former chairman of the Financial Crisis Inquiry Commission, a blue-ribbon panel appointed by President Barack Obama in 2009 to conduct a postmortem on the causes of the subprime mortgage disaster. In September 2008, American International Group Inc. didn't have the money to back the swaps it had sold guaranteeing billions of dollars' worth of mortgage-backed securities. To prevent AIG's failure from cascading through the global financial system, the U.S. Federal Reserve and the U.S. Treasury Department executed a $182 billion bailout of the insurer.

"When you look at this corporate eBond, it's strikingly similar to what was done with mortgages," says Angelides, a Democrat who was California state treasurer from 1999 to 2007. "Credit-default swaps were embedded in mortgage-backed securities with the idea that they'd be made safe. But the risk wasn't insured; it was just shifted somewhere else."

McQuown and MacWilliams counter that soon CDSs will not pose the systemic threat they did in 2008. Back then, they were traded between two parties in an unregulated and unaccountable system. To bring the $19 trillion CDS market out of the shadows, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 mandated that most of these securities be traded through exchanges and processed by clearinghouses that guarantee settlement and record every transaction in a database open to regulators. The SEC is writing rules to implement the measure. (Bloomberg LP operates a swap execution facility for trading these derivatives.)

The two men are betting these new safeguards will ease worries about swaps. ICE, the No. 1 global clearinghouse for credit derivatives, will process the swaps used to create eBonds. ICE requires sellers of swaps to backstop their contracts with various margin accounts. If the seller fails to pay off, then ICE can tap a "waterfall" of margin funds to make the investor whole. In the event of a market crash, it can call on clearing members such as Citigroup and Goldman Sachs to pool their resources and fulfill swap contracts. There's still a danger that the banks themselves may be unable to muster cash in a crisis. But this shared responsibility marks a sea change from the bad old days when investors gambled their counterparties would make good on their contracts.

> 'THERE'S A LOT OF EXPERIMENTATION IN THE MARKET,' FINADIUM'S JOSH GALPER SAYS. 'INNOVATION DOES NOT ALWAYS REDUCE RISK.'

IT'S LATE AFTERNOON AT STONE EDGE Farm, and McQuown is meeting with MacWilliams and eBond Advisors CEO Bryan Jennings in his billiards room as shadows stretch across the swimming pool outside. The three men are discussing the restructuring of the derivatives market since the crash.

"We could never have developed eBonds without Dodd-Frank and centralized clearing," says MacWilliams, 62, an easygoing man who rides in the Krewe of Hermes parade in his hometown of New Orleans every Mardi Gras.

"In 2008, it wasn't the swap that was broken—it was trust and faith in the system," adds Jennings, 48, who headed fixed-income capital markets and derivatives at Morgan Stanley from 2003 to 2012.

"It's absolutely stupid to have a derivatives market based on bilateral trading," McQuown chimes in. "And to load up dealers with an inventory of credit-default swaps is the second-dumbest thing imaginable. Centralized clearing is one of the benefits of '08, and I think it'll change the debt markets."

As he strolls the grounds, it's quickly evident that the proprietor of Stone Edge Farm is a man of eclectic tastes. Vegetable beds teem with squash and tomatoes and 40 125-year-old olive trees have been replanted with geometric precision in parallel rows. McQuown, who grew up in a farming family in northern Illinois, employs his own arborist to tend to the live oaks and California bay trees on his estate. He's inclined to go overboard when he delves into new projects. Years ago, his wife, Leslie, bought him a backyard telescope only to see it go untouched. When McQuown finally decided he needed "to know" astronomy, he purchased a "deep-sky" telescope with a 20-inch mirror and housed it in a three-story-high observatory clad in rust-colored steel that resembles a Mayan pyramid. "He hasn't changed that

McQuown's **Sonoma property** displays his eclectic tastes, mixing the old and the new.

much since I first met him more than 50 years ago," says Fama, 76, a finance professor at Chicago Booth. "He has a basic curiosity about everything."

After earning a degree in mechanical engineering from Northwestern University and then an MBA from Harvard in 1961, McQuown embraced an emerging discipline called computer science. As a young analyst in Smith Barney's corporate finance unit in Manhattan, he spent his weekends renting time on an IBM 7090, a room-sized mainframe installed in the basement of the Time-Life Building. McQuown wanted to see if he could predict how stocks would perform, so he built a database and then slept next to the whirring machine as it ran his programs. He says with a laugh that he failed in his quest.

By 1970, McQuown was leading the management sciences research division at Wells Fargo & Co. in San Francisco. He was blown away by Fama's theory that equity prices reflect all available information, so it's virtually hopeless to beat the market over time. McQuown also studied Sharpe's work. Sharpe had developed formulas, including one that came to be known as the Sharpe ratio, to quantify the relationship between risk and return and concluded, as did McQuown, that a wise way to make money in the stock market was essentially to invest in all of it.

This particular stream of thought arrived at a time when investors typically put their faith in star stock pickers. "It was an exciting time because finance and investing were in a pre-scientific era," recalls Sharpe, 80. "Mac was a guy who said, 'Surely we can bring economics and mathematics to bear in this area and optimize a portfolio.' That required algorithms and serious computing power."

In July 1971, McQuown's team of brains unveiled a $6 million portfolio that tracked 1,500 equities trading on the New York Stock Exchange for the pension fund at luggage-maker Samsonite. It would take Bogle, who developed his Standard & Poor's 500 Index mutual fund in 1975 separately from McQuown, to bring low-cost index investing to the masses through Vanguard. More than four decades later, index-based mutual funds and exchange-traded funds hold $10 trillion in assets, according to Statista Inc., a New York–based research group. The project left McQuown with an unshakable belief that financial engineering could make investing more efficient and less risky.

It could also prove quite lucrative, as he found when he shifted into credit analysis in the 1990s and formed a firm in San Francisco called KMV with Stephen Kealhofer, a University of California at Berkeley finance professor, and Oldrich Vasicek, a Czech mathematician. The trio recognized that credit ratings often don't accurately reflect a company's likelihood of defaulting on its liabilities. So they developed complex mathematical formulas based on a company's stock option pricing to calculate this probability with greater depth than can be found in conventional credit reports.

As an entrepreneur, McQuown savored exploiting such inefficiencies. In 2004, at the age of 70, he co-founded DCI with Kealhofer to profit by predicting and managing the default risk in corporate bonds and CDSs.

Yet McQuown was also driven by an engineer's desire to replace a flawed machine with a better one. For years, McQuown and MacWilliams had kvetched about how antiquated the bond market seemed compared with stocks, futures and other securities. MacWilliams had gotten to know McQuown in the early 1990s, when he headed EJV Partners LP, a bond data provider that did business with KMV.

In the aftermath of the 2008 crash, the two men rapped by phone daily about how to take advantage of the restructuring of Wall Street. "There is a clear thread from Wells Fargo to the eBonds concept," says David Coulter, the vice chairman of Warburg Pincus LLC, the New York–based private-equity firm, and an adviser to eBond Advisors. "Once again, Mac's asking 'How do markets function? Are they efficient? And if not, what can we do about it?'"

When President Obama signed Dodd-Frank in July 2010, McQuown and MacWilliams found their opening in Title VII of the 848-page law. Credit-default swaps, developed in 1994 by Blythe Masters, an economist then working on JPMorgan's derivatives desk, were originally designed to help banks cover losses in the event their borrowers failed. Within 14 years, the instrument's purpose had become warped

> 'GENIUSES PURSUE COMPLEXITY,' VANGUARD'S JOHN BOGLE SAYS. 'ANY INNOVATION IN THE FINANCIAL FIELD IS LIKELY TO FAIL.'

BLOOMBERG TIPS

For more details about eBonds, you can use the Bloomberg Law Search (BBLS) function to display the patent that John "Mac" McQuown filed for creating and trading the securities. Type **BBLS <Go>** and click on Patents under Content Searches on the left side of the screen. Next, tab in to the INVENTOR(S) field, enter *JOHN ANDREW MCQUOWN*, press <Go> and click on the Search button on the red tool bar. In the list of results, click on the item titled U.S. Patent No. 8,732,068, Creation and trading of multi-obligor credit default swap-backed securities. For an overview of trading in corporate bond markets, type **FICM <Go>** for the Fixed Income Credit Monitor function.

JON ASMUNDSSON

as banks and insurers sold unsecured swaps supposedly to guarantee subprime mortgage-backed bonds.

Now, McQuown and MacWilliams are wagering that this maligned derivative will ultimately justify its usefulness. They point out that the junk bond, another innovation that was once viewed as a financial weapon of mass destruction, has become an uncontroversial tool. With investors required to trade and clear swaps in an open and accountable marketplace, "We can return credit-default swaps to their original purpose—to transfer risk," MacWilliams says.

To create the new instrument, eBond Advisors' lawyers added three sections to the standard contract that bond issuers provide to bond buyers. Even so, McQuown and his partners may have difficulty finding investors willing to sell the swaps to embed in the eBond because the market has yet to fully recover from the crash. In the second week of January, investors traded $86 billion worth of contracts, a 37 percent drop from the same week in 2011.

Moreover, Jennings is having a hard time persuading chief financial officers to take a chance on using eBonds amid the fixed-income boom."No one has a problem raising capital right now," Jennings says. "The biggest challenge, without a doubt, is overcoming the question of, 'Has anyone else done it?'"

There's a bigger problem with the eBond—and, for that matter, with financial engineering in general—says Wallace Turbeville, a senior fellow at Demos, a New York–based think tank. The bond is a simple instrument with a debtor and creditor that's proven its utility for centuries. The eBond inserts a third party into the transaction—the seller of the swap embedded in the security who now bears its credit risk. Such machinations may be designed with good intentions, but they just further convolute the marketplace, says Turbeville, a former investment banker at Goldman Sachs. "Why are we doing this? Is our society better off as a result of this innovation?" he asks. "You can't destroy risk; you just move it around. I would argue that we have to reduce complexity and face the fact that it's actually good for institutions to experience risks."

BACK AT STONE EDGE FARM, IT'S A balmy evening and McQuown has invited MacWilliams and Jennings to join him and Leslie for dinner at an outdoor table. The couple's chef serves a deconstructed eggplant Parmesan salad with heirloom cherry tomatoes and rocket from the farm's organic garden, and glasses are filled with the 2006 vintage of McQuown's cabernet sauvignon, which sells in the secondary fine-wine market for $110 a bottle.

McQuown, shown in his **woodworking shop** at Stone Edge Farm, is an inventor at heart.

As the conversation turns to "complexity theory," an interdisciplinary approach developed by physicists at the Santa Fe Institute to analyze systems such as the oceans or the brain, McQuown is in his element. For him, the capital markets are an ever-changing machine to be tuned and re-engineered indefinitely.

McQuown's breakthroughs with index funds and credit- default analysis worked to the benefit of investors. The question now is, will his tinkering do the same as the bond market heads into a crucial transition?

"There's going to be a lot of experiments, and more power to those that are trying to figure out solutions," McQuown says on the phone a few weeks later. "Otherwise, we'll end up with financial dysfunction, and there's really no reason for that."

He's about to describe an idea for a new type of mutual fund when he has to hop off the call. Someone calls from the gate. It's a group of researchers from the Institute for the Future, a Palo Alto, California–based group that forecasts social and technological trends. They're not interested in bonds or CDSs. No problem. The engineer is happy to show them how his microturbine and solar array will soon shift his entire compound off the grid.

Edward Robinson is a senior writer at *Bloomberg Markets* in London. edrobinson@bloomberg.net

1

▸ SPECIAL REPORT ▸ EMERGING MARKETS

DEFYING THE

SOUTH KOREA, CHINA AND THE GULF NATIONS LEAD OUR ANNUAL RANKING OF DEVELOPING MARKETS—AMID A ROUT THAT HAS HIT TWO OF THE BRIC COUNTRIES.

► ILLUSTRATION BY DANIEL TRIENDL

► BY SARMAD KHAN

BY MID-DECEMBER, IT LOOKED LIKE 1998 ALL OVER AGAIN. STOCKS, BONDS AND CURRENCIES ACROSS THE DEVELOPING WORLD WERE PLUMMETING, AS THEY HAD 16 YEARS EARLIER WHEN RUSSIA SURPRISED

investors by defaulting on its debt. On Dec. 15, a Bloomberg index tracking 20 big emerging-markets currencies fell to its lowest level in a decade. The Russian ruble fell past 64 to the dollar for the first time ever, as the price of oil sank and international sanctions took hold. Bonds issued by Brazilian oil giant Petrobras Brasileiro SA nosedived amid a massive corruption probe. In December alone, investors pulled more than $4 billion from emerging-markets exchange-traded funds, erasing 48 percent of the inflow for the year, according to data compiled by Bloomberg.

As the tumult continued into 2015, discerning emerging-markets investors saw opportunity. They're bullish on China, South Korea and, despite a 50-plus percent drop in the oil price, the Gulf nations. South Korea tops *Bloomberg Markets*' fourth annual ranking of the most-promising emerging nations in which to invest in 2015, with Qatar No. 2, China No. 3 and the United Arab Emirates No. 4. Saudi Arabia heads the list of the most-promising frontier markets.

"Both Korea and China look attractive at this stage," says Mark Mobius, who oversees $40 billion as executive chairman of Templeton Emerging Markets Group. Noting that China and South Korea are oil importers, Mobius says, "Both markets will benefit from low oil prices and relatively high economic growth."

More than half of the market capitalization of South Korea's Kospi Index of stocks consists of exporters, says Hartmut Issel, head of Asia-Pacific investment at UBS Wealth Management. Samsung Electronics Co. alone accounts for 17 percent of the market. "The fate of Korean stocks is thus largely determined by how big customers such as the U.S. are doing," Issel says.

Optimism about Korea is tempered by its competitive weakness against rival Japan. "A major issue for the Korean market is the relative value of the won versus the yen," says Jim O'Neill, retired head of Goldman Sachs Asset Management. As of Jan. 12, the yen was approaching a seven-year low against the dollar. A weak currency makes exported goods cheaper. The South Korean economy grew at an anemic 0.4 percent in the three months through December, according to the Bank of Korea.

China's markets were unaffected by the emerging-markets crisis, with the Shanghai Composite Index rising 58 percent in 2014, including reinvested dividends, after slumping 3.9 percent in 2013. "I don't understand why people are so negative about China," says O'Neill, who coined the term *BRICs* in 2001 to highlight the rising economic power of Brazil, Russia, India and China. "I assumed China would grow by 7.5 percent a year this decade," he says. "So far, it will have averaged 7.9 from 2011 to 2014."

The *Bloomberg Markets* emerging and frontier markets rankings are based on 19 measures of the investing climate, from forecasts of gross domestic product growth for the next two years to the ease of doing business. MSCI Inc., a New York–based publisher of equity indexes, designates countries as emerging or frontier based on a variety of criteria, including trading volumes, restrictions on foreign investors, corporate governance, and currency and political stability. In 2014, MSCI moved Qatar and the U.A.E. from the frontier to the emerging index, which helped them pull in $3.5 billion from global emerging-markets funds, according to EFG-Hermes Holding SAE.

South Korea, widely considered a developed market, remains on MSCI's emerging list because of limits on the convertibility of the local currency and restrictions on access to its markets.

Saudi Arabia is classified as frontier because it limits direct investment in its

Zig Zag Towers in Doha. MSCI shifted Qatar from its frontier to its emerging index in 2014.

markets to the six members of the Gulf Cooperation Council, or GCC. Others can invest only via swaps or ETFs. In July, Riyadh announced it would remove those restrictions. It may do so in April, according to two people familiar with the matter. That will set the conditions for it to be designated an emerging market as early as 2017, Sebastien Lieblich, head of MSCI Index Research, told Bloomberg in July.

The Saudi stock market had a market cap of $458 billion as of Jan. 12, making it the biggest market in the Middle East by far. The Tadawul All Share Index fell 2.8 percent in the 12 months ended on Jan. 12. Among its listed stocks are Saudi Basic Industries Corp., one of the world's largest petrochemical producers; Al Rajhi Bank, the biggest Islamic lender; and Kingdom Holding Co., the investing vehicle of billionaire Prince Alwaleed Bin Talal Al Saud.

The oil price plunge is certain to carve a hole in the budgets of the Gulf oil and gas exporters. The government of Saudi Arabia is already projecting a budget deficit of $39 billion for 2015. Yet the government of King Abdullah refused to countenance a reduction of oil production to drive up prices in meetings of the Organization of Petroleum Exporting Countries. The king died at the age of 90 in January and was succeeded by the crown prince, Salman bin Abdulaziz Al Saud. Analysts didn't expect the kingdom's oil policy to change under Salman, 79.

Money managers point out that Saudi Arabia and other Gulf nations can easily fund their ambitious domestic development projects by drawing on the dollar reserves they built up while petroleum prices were high. "GCC governments have accumulated massive surpluses in the past decade thanks to elevated energy prices," says Dubai-based Rami Sidani, the head of frontier markets investing at Britain's Schroder Investment Management.

The reserve amounts as of Jan. 12: $734 billion for the Saudis, $74.7 billion for the U.A.E. and $45.5 billion for Qatar. "The main growth driver in this part of the world is government spending," Sidani says, "and we expect these governments to proceed with that in order to diversify their economies."

BRUNO MAZODIER/FIGAROPHOTO/REDUX

MOST-PROMISING **EMERGING MARKETS**

		TOTAL SCORE	PROJECTED AVERAGE GDP GROWTH, 2015, 2016	PRICE-TO-BOOK RATIO OF PRIMARY EQUITY INDEX	TWO-YEAR SOVEREIGN CDS SPREAD, IN BASIS POINTS	EASE OF DOING BUSINESS RANK, 2015
1	SOUTH KOREA	70.7	3.6%	1.0	17.1	5
2	QATAR	69.2	6.5	2.0	50.5	50
3	CHINA	66.3	6.9	2.0	26.1	90
4	U.A.E.	65.9	3.9	1.5	101.8	22
5	CHILE	64.7	3.3	0.3	50.6	41
—	MALAYSIA	64.7	5.1	2.1	46.1	18
7	PANAMA	62.9	6.5	0.4	62.0	52
8	PERU	60.3	5.2	1.2	62.8	35
9	LATVIA	58.7	3.0	0.5	52.6	23
10	POLAND	58.5	3.4	1.3	16.5	32
11	THAILAND	58.1	4.0	2.1	37.6	26
12	CZECH REPUBLIC	57.7	2.6	1.2	25.4	44
13	HUNGARY	54.1	2.5	0.8	90.5	54
14	COLOMBIA	53.1	4.4	1.4	85.5	34
15	TURKEY	51.0	3.6	1.6	97.6	55
16	BRAZIL	48.5	1.4	1.2	129.1	120
—	PHILIPPINES	48.5	6.2	2.8	31.5	95
18	MEXICO	48.3	3.6	2.7	60.5	39
19	SOUTH AFRICA	45.5	2.6	2.2	89.1	43
20	INDONESIA	45.0	5.5	2.4	61.5	114
21	MOROCCO	43.4	4.8	2.2	126.8	71
22	RUSSIA	39.4	−0.1	0.7	285.5	62
23	GREECE	39.2	1.9	0.7	1,449.1	61
24	INDIA	35.2	5.9	3.1	70.5	142
25	EGYPT	30.8	3.6	1.8	223.2	112

FOR "HOW WE CRUNCHED THE NUMBERS," SEE PAGE 42.

Sources: Bloomberg, International Monetary Fund, World Bank, Economist Intelligence Unit, Transparency International, World Economic Forum, CIA

That makes consumer companies, construction, real estate and the banks that fund them a good bet, says Hootan Yazhari, managing director for global frontier markets at Bank of America Merrill Lynch. He recommends Dubai-based Emaar Properties PJSC and Abu Dhabi–based Aldar Properties PJSC, First Gulf Bank PJSC and Abu Dhabi Commercial Bank PJSC. In Saudi Arabia, clothing retailer Fawaz Abdulaziz Alhokair & Co. and bookstore chain Jarir Marketing Co. are among Merrill Lynch's top picks.

Elsewhere in the developing world, the crisis has opened a rift among the BRICs. "These four countries could hardly be more heterogeneous at this point," says UBS's Issel. He sees continuing turmoil in Brazil, No. 16 in the ranking, and Russia, No. 22, in 2015. "In Russia, recession is inevitable," he says.

At the same time, investors glow with enthusiasm for the other two BRIC nations. "We are most excited about the new governments in China and India, who have put reforms in place that will benefit the

economy and financial markets in 2015," says Pearlyn Wong, a Singapore-based investment analyst for Switzerland's Bank Julius Baer & Co. Narendra Modi took over as India's prime minister with a reformist economic agenda on May 26. Since then, the benchmark S&P BSE Sensex stock index was up 11.6 percent as of Jan. 12.

China's equity market should get a boost in 2015 from the stock-connect program that allows foreign investors to buy mainland shares through the Hong Kong market, says Adam Tejpaul, head of Asian investments at J.P. Morgan Private Bank. China will also benefit from lower energy prices and a dovish monetary policy by the People's Bank of China, which will provide liquidity to the country's markets, Tejpaul says.

"Company fundamentals in the mainland are increasingly positive," says Andrew Gillan, head of Asia (excluding-Japan) equities at Henderson Global Investors. "Favored holdings include Baidu, which dominates the Internet search market." Henderson also likes Brilliance China Automotive Holdings Ltd., a joint venture partner with Bayerische Motoren Werke AG, and Dongfeng Motor Group Co., which has partnerships with Honda Motor Co. and Nissan Motor Co. China is the world's biggest auto market.

Long-term investors shouldn't be deterred by the current turmoil, Mobius says. "Three key themes remain in place," he says. "Emerging markets' economic growth rates in general continue to be markedly faster than those of developed markets, emerging markets have much greater foreign reserves than developed markets, and the sovereign-debt-to-GDP ratios of emerging-market countries generally remain much lower than those of developed markets." Even with major nations like Russia and Brazil hobbled by low commodities prices, scandal and sanctions, Mobius concludes, growth rates—and share prices—in developing markets will outpace those in the U.S., Europe and Japan in 2015.

Sarmad Khan covers emerging markets at Bloomberg News in Dubai. skhan170@bloomberg.net With assistance from **Alex McIntyre** in New York and **Richard Frost** in Hong Kong.

MOST-PROMISING **FRONTIER MARKETS**

		TOTAL SCORE	PROJECTED AVERAGE GDP GROWTH, 2015, 2016	PRICE-TO-BOOK RATIO OF PRIMARY EQUITY INDEX	TWO-YEAR SOVEREIGN CDS SPREAD, IN BASIS POINTS	EASE OF DOING BUSINESS RANK, 2015
1	SAUDI ARABIA	78.8	3.5%	1.9	31.3	49
2	ESTONIA	71.4	2.7	1.1	32.9	17
3	SLOVAKIA	67.1	2.9	1.0	19.8	37
4	LITHUANIA	65.8	3.2	1.2	52.5	24
5	BAHRAIN	65.7	3.5	0.9	137.7	53
6	SLOVENIA	65.0	1.6	1.0	59.5	51
7	BULGARIA	63.8	2.1	0.6	129.0	38
8	VIETNAM	62.4	6.1	1.8	70.6	78
9	KAZAKHSTAN	61.5	4.5	0.6	231.9	77
10	ROMANIA	60.3	3.0	1.0	61.5	48
11	CROATIA	59.1	0.9	0.8	161.9	65
12	CYPRUS	58.4	0.4	0.1	433.9	64
13	LEBANON	49.7	2.9	0.8	253.7	104
14	TUNISIA	47.9	3.9	2.9	189.7	60
15	PAKISTAN	44.9	4.2	2.0	567.0	128
16	NIGERIA	43.6	6.6	1.9	308.6	170
17	ARGENTINA	40.6	0.8	1.2	8,838.6	124
18	UKRAINE	38.1	–0.1	0.5	1,934.1	96
19	VENEZUELA	23.2	–0.5	4.5	6,420.4	182

Sources: Bloomberg, International Monetary Fund, World Bank, Economist Intelligence Unit, Transparency International, World Economic Forum, CIA

▾ HOW WE CRUNCHED THE NUMBERS

Bloomberg ranked frontier and emerging markets based on their overall investment potential through 2016. We used data from Bloomberg, MSCI, FTSE, Standard & Poor's and JPMorgan to decide whether a country was emerging or frontier. Countries were awarded points for their performance in each of 19 indicators. For each variable, the worst-performing country received zero points while the best performing received the maximum number of points assigned to that variable, according to its weight. All other countries received points between these two extremes. Points were summed into a total score, with the range being zero to 100. All data were the latest available as of Jan. 2.

Economic indicators got 40 percent of the weight in the ranking and included average projected GDP growth for 2015 and 2016, plus projected inflation rate, government debt as a percentage of GDP, total investment as a percentage of GDP and current-account balance as a percentage of GDP. Also included were the current labor participation rate, foreign reserves as a percentage of GDP and World Economic Forum infrastructure score.

Financial indicators also got 40 percent of the weight in the ranking. They included the price-to-book ratio of the primary equity index, liquidity of the primary equity index over three years, exchange-rate volatility over three years, two-year sovereign-debt credit-default-swap spread and the Economist Intelligence Unit's banking risk score.

Political and social measurements (20 percent) included Transparency International's Corruption Perceptions Index score, the EIU's political risk score, the World Bank's ease-of-doing-business score and the adult literacy rate.

To access a country risk assessment spreadsheet on the Bloomberg Professional service, type **XLTP COUNTRY RISK <Go>**.

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The DEAL Chaser

SEOUL-BASED **MICHAEL KIM** HAS BUILT MBK PARTNERS, WITH $8 BILLION UNDER MANAGEMENT, INTO NORTH ASIA'S LARGEST INDEPENDENT PRIVATE-EQUITY FIRM.

▸ BY CATHY CHAN AND YOOLIM LEE

PHOTOGRAPH BY YOO YOUNG KYU ▸

ONE SULTRY EVENING IN JULY 2013, MICHAEL KIM, SEOUL-BASED FOUNDER OF PRIVATE-EQUITY FIRM MBK PARTNERS LTD., WAS WALKING INTO HIS HOUSE FOR DINNER WHEN HE RECEIVED A TEXT MESSAGE ON HIS MOBILE PHONE. "ARE YOU AVAILABLE FOR A CALL NOW?"

read the message from Frank Koster, then ING Groep NV's chief executive officer of insurance in the Asia-Pacific region.

Kim, known for his ability to write a big check as chairman of South Korea's largest buyout firm, sensed it could be the news he'd been eagerly anticipating for three weeks. During that period, ING, which was seeking to sell its Korean unit, ING Life Korea, had been locked in exclusive talks with the highest bidder, a local rival of MBK's. But Kim knew that many local PE firms, struggling to attract big investors, had limited capital. Foreign firms with deep pockets, meanwhile, were barred from buying a financial institution under Korean law.

That left MBK, Kim figured, as the only realistic suitor of Korea's No. 5 life insurer. He paused for a moment. Then instead of jumping and saying yes, he replied to Koster: "At a dinner. Call tomorrow a.m.?"

The ING executive wrote back almost instantly: "Can you step out for a minute or 2?" Kim asked Koster to call in five minutes or so. Koster did, wanting to know one last time whether Kim would consider raising his offer from the original $1.7 billion, Kim recalls. "No," he said.

Kim, a 51-year-old Korean-American who oozes the languid confidence of a man fully aware of his own worth, ended up getting the deal on his own terms after a month of negotiations. Koster, now CEO of AXA Belgium SA, says he found Kim to be a " tough, reliable and trustworthy counterparty who knows what he wants."

The ING deal turned out to be one of his smartest investments. It showed how his negotiating skills and his dominant position—as head of a Korea-registered firm backed by sovereign wealth and pension funds—propelled MBK's remarkable rise during the past decade from a startup to the largest independent PE firm in North Asia, with more than $8 billion under management.

Today, MBK—which stands for Michael ByungJu Kim, his full name—is the only major buyout fund in the world that exclusively focuses on Greater China, South Korea and Japan. Kim has presided over a surge of PE in Korea, which tops *Bloomberg Markets*' fourth annual ranking of the most-promising emerging economies. (See "Defying the Turmoil," page 38.) Growth in gross domestic product, aided by central bank interest-rate cuts and a 46 trillion won ($42 billion) stimulus package, is forecast by the Ministry of Strategy and Finance to hit 3.8 percent in 2015, up from an estimated 3.4 percent in 2014.

MBK has led the PE pack since the Korean regulator loosened requirements in December 2004, effectively eliminating capital gains taxes for such firms. Since then, the number of private-equity firms registered with the Financial Supervisory Service has soared to 271 from 15. They had a record 49 trillion won of capital under management at the end of 2014, up from 4.7 trillion won at the end of 2005.

Michael Kim holds aloft his 2014 'Big Fat Ahjussi' squash trophy.

After an uninterrupted winning streak, Kim has hit a snag. After seven years of investment, MBK is under pressure to sell C&M Co., a Seoul-based cable TV service provider that the fund and its partner acquired for $2.35 billion in 2008 and subsequently expanded by buying another firm. Adding to Kim's troubles, more than 100 former C&M subcontract workers were on strike for five months until Dec. 31, when their labor union accepted C&M's proposal to have them re-employed by other subcontractors. Two of the strikers garnered Kim unwanted publicity, dramatizing their grievances by stationing themselves atop a 20-meter-high (66-foot-high) billboard for seven weeks outside the Seoul Financial Center, in which MBK's office is located.

"All eyes are on MBK's exit of C&M now," says Lee Jae Woo, chairman of the Korea Private Equity Association and a co-founder of Vogo Investment, a Seoul-based PE firm. "But people need to look at the fund's overall performance holistically, not one single investment."

MBK started the process of selling C&M in mid-January, hiring Goldman Sachs Group Inc. to attract prospective buyers. But several forces are aligned against MBK. Like other Korean cable TV operators, C&M has been facing growing competition since early 2008, when the government allowed telecommunication companies to broadcast programs in real time over their broadband networks, according to Moon Jee Hyun, an analyst at KDB Daewoo Securities Co. in Seoul. What's more, large family-owned businesses, or *chaebols*—known for their appetite for expansion—may be refraining from buying major assets under the government of President Park Geun Hye, who took office in 2013 pledging to counter their vast power. To discourage cash hoarding by corporations, the government last year announced plans to levy a 10 percent punitive tax on excessive cash piles.

PREVIOUS SPREAD: STYLIST: LEE JI YOUNG; HAIR: KANG HYUN JIN; GROOMING: WON JO YEON; THIS PAGE: COURTESY OF MBK PARTNERS

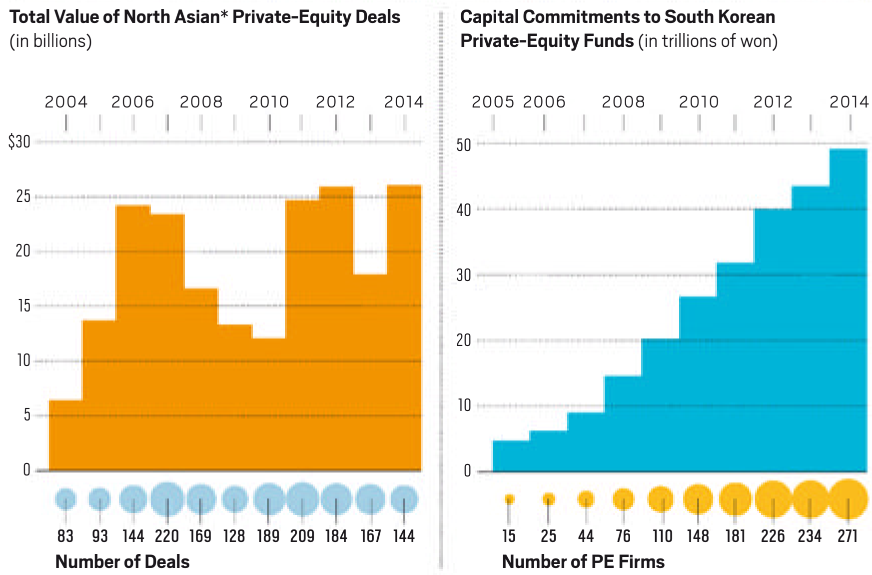
Then there are new rivals with formidable career and family backgrounds who are closing in on Kim. Scott Hahn, a former chief investment officer for Asia at Morgan Stanley Private Equity who founded Seoul-based Hahn & Co. in 2010, is one of them. Like Kim, Hahn, a 43-year-old Korean native with a degree from Harvard Business School and experience on Wall Street, has shown he's able to raise money from international investors. In 2014, Hahn & Co. and its partner Hankook Tire Co. acquired Daejeon, South Korea–based Halla Visteon Climate Control Corp., the world's second-largest supplier of automotive climate control parts, for $3.6 billion.

Global PE firms are also returning to Korea, the region's brightest spot in terms of sustained deal flow, according to Bain & Co.'s *Asia-Pacific Private Equity Report 2014*. In 2009, KKR & Co. beat MBK and acquired Korea's Oriental Brewery Co. for $1.8 billion, selling it back to Anheuser-Busch InBev NV for $5.8 billion in 2014. Overseas buyout firms had reduced their investments in Korea in the mid-2000s—spooked by a mounting public backlash against billions of dollars of gains foreigners had reaped from Korean assets following the 1997–1998 Asian financial crisis. "Unlike Japan, where private equity developed over years in an evolutionary way, private equity hit Korea like a revolution," Kim says. "It was very controversial." Global firms—including KKR, Carlyle Group LP, TPG Capital and CVC Capital Partners Ltd.—have together raised $16.7 billion dedicated to Asia-Pacific investments in the 18 months since July 2013. "Everyone's coming back," Kim says, adding that homegrown companies with local networks have an advantage over global firms in sourcing local deals.

DEREK MURPHY, SENIOR vice president of private equity at Ottawa-based Public Sector Pension Investment Board, one of the founding investors of MBK, says that to remain pre-eminent in PE, Kim needs to continue to take advantage of his solid investor base. "Michael needs to 'own' the large deal market in Korea and ensure that all large deals come to MBK first and foremost," Murphy says. Since its inception a decade ago, MBK has fully or partially sold 11 companies in its first two funds, including China Network Systems Co. in Taiwan, whose sale is pending regulatory approval. Those exits have returned an estimated $3.84 billion to investors, generating a return of 2.6 times on equity invested.

PE BOOM

Since Korea loosened requirements for private-equity funds, the industry has taken off.



*Data exclude VC and government deals. *North Asia refers to China, Japan and South Korea.*
Sources: Asian Venture Capital Journal, *Korean Financial Supervisory Service*

KIM SAYS SOUTH Korea will continue to be the most dynamic market for buyouts in Asia. "Korea is Google to Japan's IBM," he says. MBK allocates up to 50 percent of its funds toward Korea and the rest in China and Japan. Kim says that as a buyout market, China is just emerging and will become the most important market one day. For a country to be a sustainable buyout market, he says, it needs to have a population greater than 50 million and a per capita gross domestic product of more than $30,000. Only seven countries are in that club, and Korea is one of them. The others: the U.S., the U.K., Germany, France, Italy and Japan. South Korea's population is 50.4 million, and its GDP per capita on a purchasing-power-parity basis is $35,485, according to 2014 data from the International Monetary Fund. Though Korea is the world's 13th-largest economy, it's still considered an emerging market under MSCI Inc. criteria.

Even before he set out on his own with MBK, Kim had been one of the most prominent financiers in the country. After graduating from Harvard Business School in 1990, he rejoined Goldman Sachs and gained experience as an M&A banker. In 1995, he joined Salomon Smith Barney, which three years later became part of Citigroup Inc. There, he led the issuance of sovereign bonds worth $4 billion in 1998.

At Carlyle Group, where he served as Asia president for six years, until 2005, he led the firm's $450 million investment in KorAm Bank, which was later sold to Citigroup for $2.7 billion.

Seated in a 20th-floor MBK conference room, dressed in a gray blazer with a colorful handkerchief peeking out of the breast pocket, Kim acknowledges that he hasn't gotten to where he is entirely on his own. He says his marriage to Park Kyung–Ah, a daughter of late Korean Prime Minister Park Tae-Joon, opened many doors for him. Kim's father-in-law built Posco into one of the world's biggest steelmakers from

scratch. He also was one of the most trusted lieutenants of former President Park Chung Hee, under whom Korea became an industrial powerhouse. Park Chung Hee, whose daughter Park Geun Hye is now president, governed Korea from 1961 until his assassination in 1979 by the head of his own security services.

On his first visit to Asia, in 1998, then–Citigroup Co-Chairman Sanford "Sandy" Weill chatted with Kim over dinner. He was so impressed by Kim's knowledge of Korean and Japanese banks that he asked the young Salomon banker to hop on his corporate jet and fly with him to Tokyo. During the flight, Kim sat next to his boss and fielded his intense questions. Their relationship blossomed. "I always thought Michael was the kind of young man who really deserves success," says Weill, now 81. "He worked hard. He had good ethics. And he was very respectful." Weill says Kim has always addressed him as "Mr. Chairman."

Kim set up MBK in 2005 with five senior Asian executives from Carlyle. Kim says one of MBK's earliest and most ardent supporters was someone who "thought it was high time that we have Asians running an Asian firm." He's referring to Ho Ching, CEO of Temasek Holdings Pte, Singapore's state investment company, which

MBK'S BUYING SPREE

	C&M	ING Life Korea	Coway	USJ	Nepa
	Cable TV service provider (Korea)	Life insurance	Water and air purifier maker (Korea)	Universal Studios Japan theme park	Outdoor apparel brand (Korea)
Deal Value	$2.35 BILLION	$1.7 BILLION	$1.1 BILLION	$1.4 BILLION	$869.6 MILLION
MBK Equity	$578.5 MILLION	$711.2 MILLION	$518.1 MILLION	$183.3 MILLION	$290.3 MILLION
Acquisition Completed	MARCH 2008	DECEMBER 2013	JANUARY 2013	MAY 2009	APRIL 2013

Source: MBK

has S$223 billion ($167 billion) of assets. Ho put up several hundred million dollars in 2005 to get MBK started. "She basically put us in business," Kim says. "We do invest in funds where they give us new exposure to new sectors and geographies," says Stephen Forshaw, a Temasek spokesman. "We often keep long-standing relationships with many funds, global and regional."

MBK invests in leading consumer businesses, among others. They include Nepa Co., one of Korea's biggest outdoor apparel companies, which MBK acquired for $869.6 million, and Coway Co., Korea's biggest health appliance maker, which it purchased for $1.1 billion. It also acquired Komeda Co., one of Japan's largest coffee chain operators, for $470.5 million.

Kim credits his success to being in the right place at the right time. He grew up in an affluent family in Seoul. It was his father, Kim Ki Yong, a businessman who later owned an insurance company, who set his son's future course by sending him to the U.S. at the age of 12. Michael attended private schools in Cherry Hill, New Jersey, before enrolling at Haverford College in Pennsylvania. He majored in English literature, leading to his lifelong love of the language. "Don't come back until you have mastered English," he recalls his father saying to him. During the summer before his 50th birthday in October 2013, he reread all of Shakespeare's major works.

So driven was Kim when chasing the KorAm deal that his Carlyle colleagues nicknamed him "Captain Ahab," after the whale hunter in Melville's *Moby-Dick*. Kim says KorAm became an obsession. "It was my Moby-Dick, and I was obsessed with it."

Kim—5 foot 10, with thick black hair—prefers a 45-minute squash game over five hours on the golf course. "I have this bad habit of looking at everything in terms of opportunity cost, especially when it comes to my time," he says. He plays squash with Eric Hoffman, an American who's been chief commercial officer at Aon Risk Solutions Korea since 1998. For nine years, they've played a couple of times a week when not traveling. At the end of each year, the one who's won the most games gets to keep a trophy proclaiming him "Big Fat Ahjussi." (*Ahjussi* means *middle-aged man* in Korean.) "Michael really wants to win" Hoffman says.

Last year, Kim did. He won 30 games to Hoffman's 29. Kim can only hope he'll be equally successful in finally selling off MBK's cable TV companies in Taiwan and Korea. He says he's learned not to panic in his line of work. Recalling the days when he waited for the fateful call from Frank Koster of ING, he says: "Every deal has twists and turns. That's where patience and discipline are required."

Cathy Chan covers private equity in Asia at Bloomberg News in Hong Kong. kchan14@bloomberg.net **Yoolim Lee** is a senior writer at *Bloomberg Markets* in Singapore. yoolim@bloomberg.net

BLOOMBERG TIPS

Tracking MBK

You can use Bloomberg's suite of private-equity functions to find more information about MBK Partners. First, type **PE <Go>** on the Bloomberg Professional service for the Private Equity Overview function. Enter *MBK PARTNERS* in the field and click on the PE General Partner item in the list of matches. To see a list of investors in MBK's three funds, click on Investors at the top of the screen. For a list of the firm's investments, click on Portfolio at the top of the screen. For details of the acquisition of C&M Co., for example, scroll down in the list of portfolio companies and click on the cable TV service provider's name. Type 11 <Go> for a description of the transaction.

JON ASMUNDSSON

ILLUSTRATIONS BY JASON LEE

WHAT'S DRIVING MEXICO?

► BY BEN BAIN
► PHOTOGRAPHS BY SPENCER LOWELL

THE ANSWER IS CARS. WITH GLOBAL AUTOMAKERS RAPIDLY EXPANDING, INVESTORS PICK THE COUNTRY TO OUTPERFORM.

The year-old **Nissan plant** at Aguascalientes is part of $20 billion in new investment by global auto companies.

SPARKS FLY AS 200

robots weld and bolt together Nissan Sentras at one of the Japanese company's factories in Aguascalientes, Mexico, on a cool December morning. The $2 billion facility, opened in November 2013, churns out 600 gleaming new cars a day and employs 3,000 workers. Acres of autos sit in the sun outside the plant, waiting to be loaded onto trains bound for the U.S., where consumers enjoying the lowest gasoline prices in five years are crowding auto dealerships.

The 192,000-square-meter (2.1-million-square-foot) Nissan Motor Co. plant is one of half a dozen that have sprung up or been announced for central Mexico's industrial belt in the past five years, contributing to a nationwide $20 billion investment by global automakers eager to establish ready access to the U.S. market. Mexican vehicle exports are expected to rise to a record 2.9 million in 2015, with more than 70 percent of the cars and light trucks headed to the U.S., according to the Mexican Automobile Industry Association, or AMIA. December exports alone were up 21 percent over the previous year, to 195,091. Mexico is also the world's sixth-biggest manufacturer of auto parts, with an estimated $81.5 billion in sales in 2014, according to trade group INA.

"The growth in production and in exports has been spectacular," Eduardo Solis, the AMIA's president, told reporters in January. "The growth reflects the confidence the industry has in our country."

The burgeoning auto industry is just one example of Mexico's manufacturing prowess—and one reason investors think it will outperform the rest of Latin America in 2015. "The growth pickup in the U.S. is going to be felt first and foremost in countries like Mexico," says Gerardo Rodriguez, a BlackRock Inc. portfolio manager. "Going into 2015, clearly Mexico is one of the markets that's looking attractive."

Mexico is No. 18 in *Bloomberg Markets*' ranking of the 25 most-promising emerging markets in which to invest.

The nation has had a rocky couple of years. Estimates of 2014 economic growth are just 2.1 percent—low for an emerging market—after gross domestic product expanded 1.4 percent in 2013, President Enrique Pena Nieto's first full year in office. Turmoil in developing nations last year sent the peso into a 12 percent tailspin, forcing the central bank to intervene. Mutual, pension and hedge funds tracked by research firm EPFR Global yanked $3.66 billion out of the nation's stock market. The benchmark IPC stock index gained little ground in 2014 after slipping 2.2 percent in 2013. And the expected rush of new oil and gas investment after Pena Nieto opened the industry to foreign competition could be stalled by plummeting oil prices. More important, if low oil prices persist, Mexico's budget will get a shock, since the government depends on Petroleos Mexicanos, the state-owned oil company, for a third of its tax receipts. Mexico hedged its oil sales for 2015 and is guaranteed $76 a barrel, but that hedge will end late in the year.

Still, investors expect 2015 to be a turnaround year. "Mexico is among our clear favorites in terms of fixed income and equities," says Jorge Unda, chief investment officer for Latin America at Spanish bank Banco Bilbao Vizcaya Argentaria SA. "Of all the emerging markets, it's the most related with the American economy, and the American economy is going to continue growing."

The U.S., where GDP shot up 5 percent in the third quarter of 2014, is the destination for 80 percent of Mexican exports, which include, in addition to oil and cars, flat-screen televisions, mobile phones, computers and airplane components. Total Mexican exports added up to $363 billion in the first 11 months of 2014—85 percent of them from manufacturing.

"There's very little debate, very little questioning of Mexico's manufacturing competitiveness," says Nikolaj Lippmann, Mexico equity strategist at Morgan Stanley. "That is very much something investors take for a given at this stage."

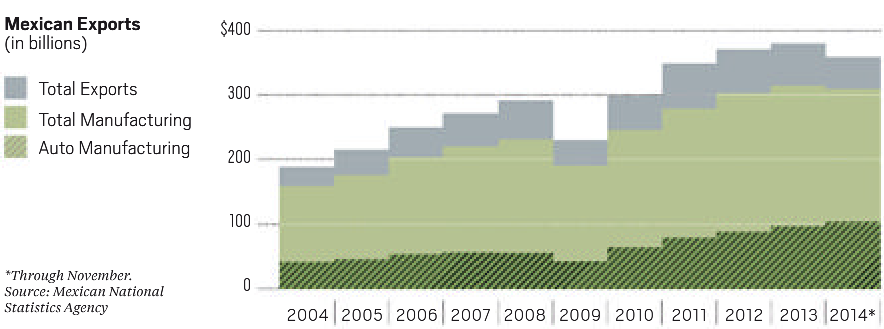
And the labor comes at a low price. Mexican autoworkers make an average of 20 percent of what their U.S. counterparts do, according to Luis Lozano, a partner at PricewaterhouseCoopers in Mexico City.

Eric Conrads, an equity portfolio manager at ING Groep NV, picks Mexico over Chile, which tied for fifth in the *Bloomberg Markets* ranking; Peru, No. 8; and Brazil, which tied for 16th. Brazil is afflicted with stagflation, Conrads says, while Colombia, No. 14, will be hit by the oil price slide, and Chile is suffering from the low price of copper. "You need to focus on countries that are doing their homework," he says. "Mexico, it's a better move."

The challenge for foreign investors is finding a way to buy into Mexican manufacturing. "Almost 100 percent of the economic growth in Mexico has been externally driven," Lippmann says. "The problem equity investors have is that there's just very few ways of playing that." Morgan Stanley recommends investing in stocks tied to Mexico's expected economic recovery,

EXPORT POWER

In addition to cars, Mexico builds computers, televisions and airplane components.



**Through November.*
Source: Mexican National Statistics Agency

Robots weld Nissan Sentra chassis. Mexico could produce 5 million cars a year by 2020.

including construction and real estate. After a recent selloff, valuations look "quite attractive," he says.

BlackRock's Rodriguez says one of the best ways to profit from Mexico's resurgence is through long-term government bonds. Thirty-year, fixed-rate, peso-denominated government debt yielded an average of 3.7 percentage points more than similar-maturity U.S. Treasuries in the four years ended on Dec. 31. "There's not many places in the emerging-markets space in which you can go that deep with reasonable liquidity," says Rodriguez, a former Mexican deputy finance minister. He says a lack of equity options also makes structured credit, real estate and private equity appealing.

Economists project Mexico will grow 3.4 percent in 2015, its quickest pace since 2012 and faster than Brazil, Chile or South Africa. Pena Nieto's opening of the oil and telecommunications industries will help Latin America's second-biggest economy grow by more than 5 percent a year in the long term, Deutsche Bank AG analyst Esteban Polidura wrote in a December report.

Investors are also bullish on the peso. Analysts forecast in January that the currency, after tumbling last year, would rebound by 9.3 percent in 2015, the second-biggest predicted gain against the greenback, after Russia's ruble, among 31 major currencies tracked by Bloomberg.

The boom in Mexican manufacturing is anchored by auto production, which increased 10 percent last year over 2013, according to the AMIA, and is projected to reach 5 million vehicles by 2020.

On the Aguascalientes Nissan site, construction is about to start on another plant, a joint venture between Nissan and Germany's Daimler AG that will make both Infiniti and Mercedes-Benz luxury vehicles. Another maker of luxury cars, Audi AG, also has plans to produce in Mexico starting in 2016, joining its parent company, Volkswagen AG, which makes more than 475,000 cars, including Beetles, Golfs and Jettas, in the country every year.

In December, General Motors Co., which made 678,388 automobiles last year in Mexico, announced it would spend $3.6 billion through 2018 to modernize its four Mexican plants.

The manufacturing hasn't been enough to save Pena Nieto's popularity, which plunged to 39 percent late last year in a Grupo Reforma poll amid slow growth and raging protests over his government's handling of the disappearance of 43 students, who were allegedly killed by drug gangs working with local police. His approval rating, down from 50 percent just four months earlier, has also been slapped by conflict-of-interest scandals in his administration.

The automakers haven't been kept away by the drug violence, which reached a peak under Pena Nieto's predecessor, Felipe Calderon. Keishi Egawa, chief executive officer of Mazda Motor Corp.'s Mexico unit, says the Guanajuato region, where Mazda opened a $770 million factory in early 2014, is relatively safe and that his only crime problem has been theft. For that reason, Mazda ships some cars out of the country by sea rather than train.

The 5,000-employee Mazda plant will become the biggest overseas facility for the Hiroshima, Japan–based producer as it increases production to 250,000 vehicles annually by early 2016. About half of the vehicles are being exported to the U.S. and Canada. Egawa says the country's proximity to the U.S. and its relatively open trade policies push aside all other considerations. "Mexico is one of the most attractive manufacturing locations," Egawa says. "The potential for growth in Mexico is still tremendous."

Ben Bain covers markets at Bloomberg News in Mexico City. bbain2@bloomberg.net With assistance from **Brendan Case** and **Nacha Cattan** in Mexico City.

BLOOMBERG TIPS

Screening for Mexican Auto-Parts Makers

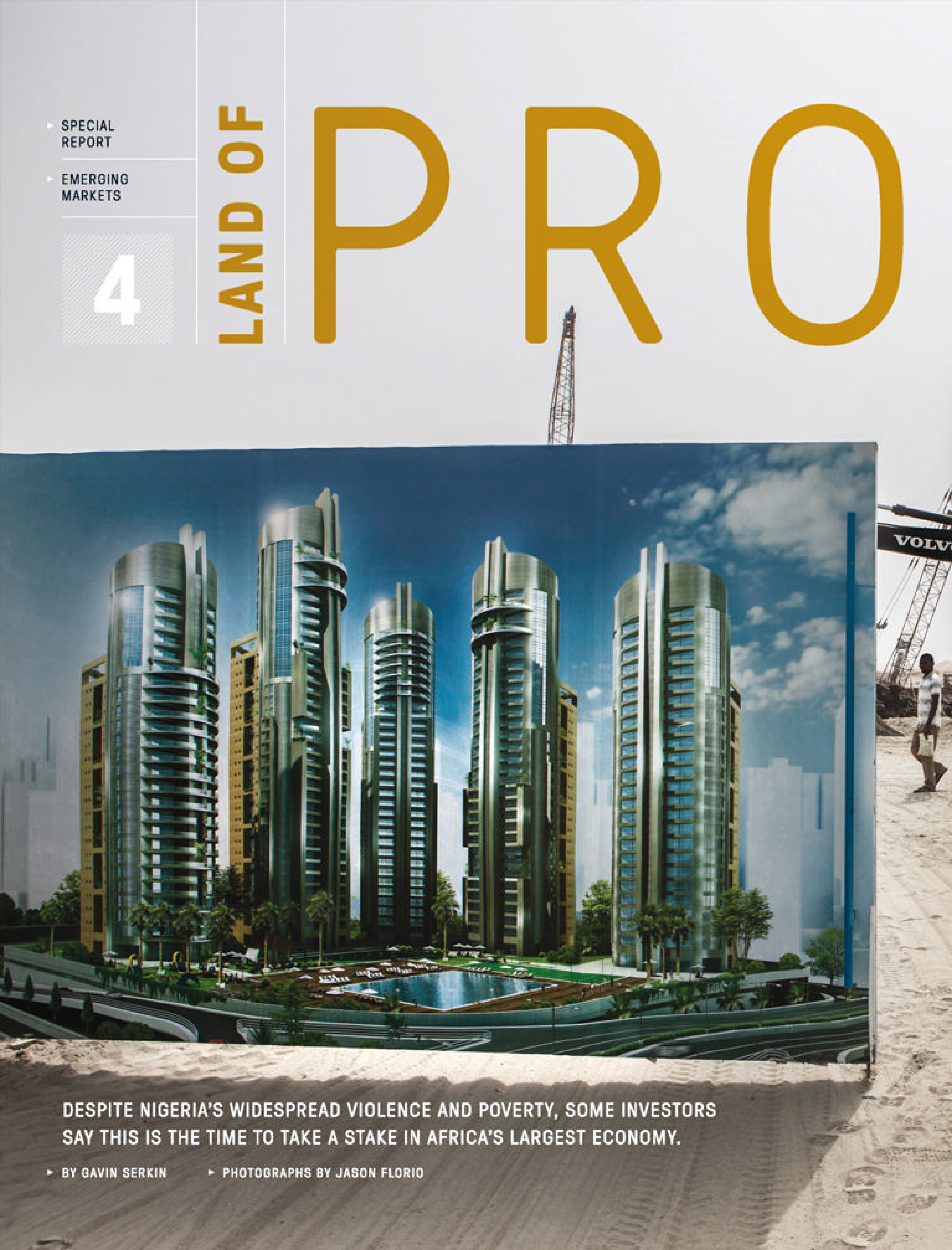
Type **EQS <Go>** to search for Mexican companies that make auto parts. Tab in to the ADD CRITERIA field, enter *MEXICO* and click on the Country of Domicile item in the list of matches. Tab in to the field again, enter *PRODUCT* and click on Product Segment Market Participation. In the Product Segmentation window that appears, enter *AUTO* and press <Go>. Scroll down to Search Results in the Product Segments section and click on Auto Parts Manufacturing. Click on Update and then on Results. The search turns up suspension and brake maker Rassini SAB de CV, whose stock gained almost 500 percent in 2014.

JON ASMUNDSSON

- SPECIAL REPORT
- EMERGING MARKETS

4

LAND OF PRO

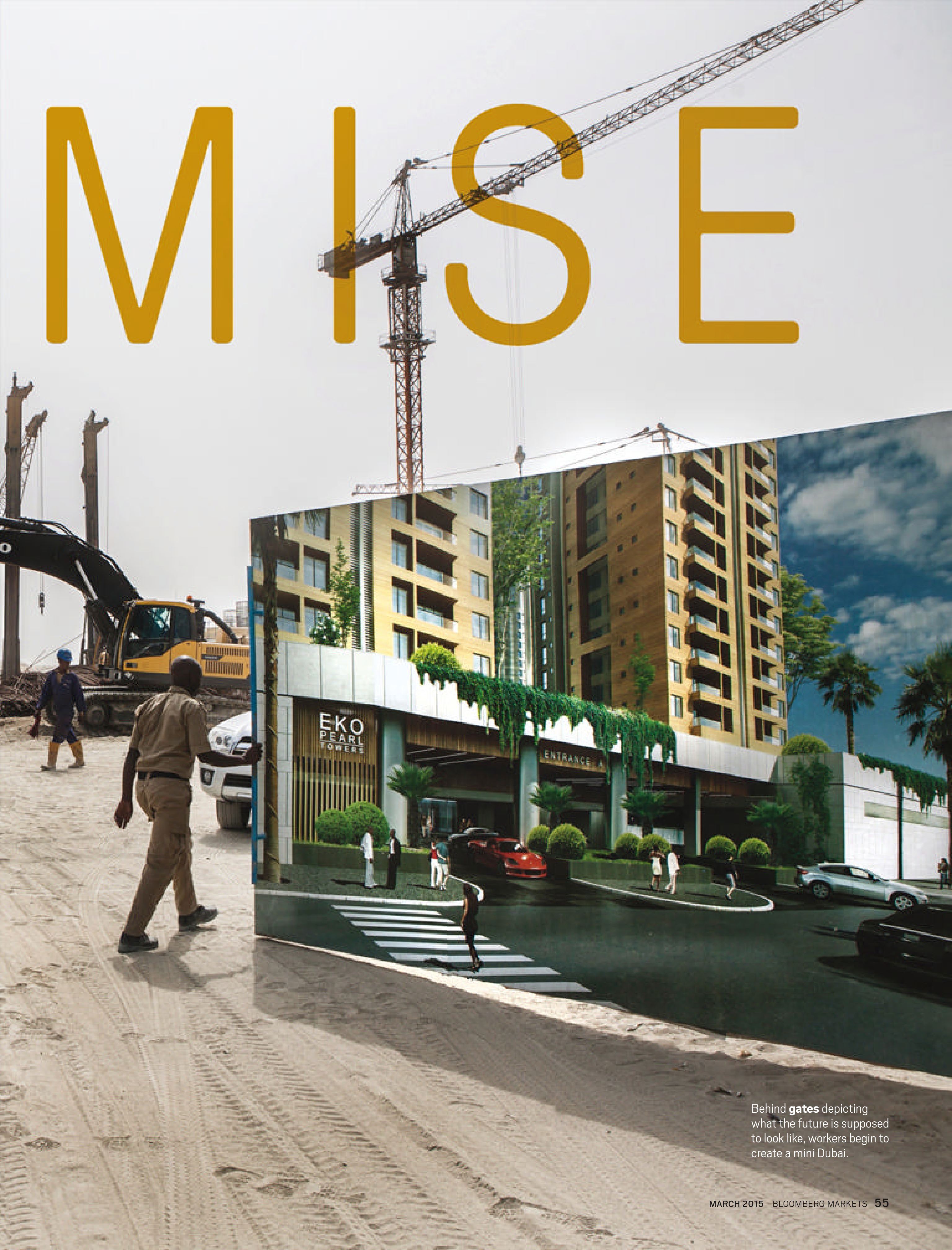


DESPITE NIGERIA'S WIDESPREAD VIOLENCE AND POVERTY, SOME INVESTORS SAY THIS IS THE TIME TO TAKE A STAKE IN AFRICA'S LARGEST ECONOMY.

BY GAVIN SERKIN

PHOTOGRAPHS BY JASON FLORIO

MISE



Behind **gates** depicting what the future is supposed to look like, workers begin to create a mini Dubai.

IN THE NIGERIAN SLUM OF MAKOKO, SHACKS ON STILTS RISE FROM THE LAGOS LAGOON, A PALPABLE MANIFESTATION OF THE POVERTY, LAWLESSNESS AND DEPRIVATION THAT AFFLICT AFRICA'S MOST POPULOUS NATION. CHILDREN SPLASH IN THE DARK WATER, A BREEDING GROUND FOR DIARRHEA, TYPHOID AND MALARIA. NEARBY, Samuel Pelumi, 24, taps away on a laptop with a damaged screen. A zoology major at the University of Lagos, Pelumi is studying how controlling pollution could mitigate the dangers from the diseases to which Makoko's residents are exposed. "I need to find solutions," he says.

Ten kilometers (6 miles) south, where the lagoon meets the Atlantic, a very different sort of community is rising from the water. A 100,000-concrete-block Accropode breakwater holds the ocean back from a land-reclamation area destined to become the Dubai-like Eko Atlantic. If all goes according to plan, this will be a 10-square-kilometer (4-square-mile) complex of skyscrapers, eight-lane boulevards, shopping malls and a yacht marina. For the time being, 4-meter-deep (13-foot-deep) craters—future parking garages—pockmark a desolate sandscape.

Makoko and Eko Atlantic—flip sides of Africa's largest city, with a metropolitan population of 11 million—sum up what repels and allures investors with an eye on Nigeria. I meet one of them, London-based Kevin Daly, who invests $13 billion in emerging-markets debt as a portfolio manager for Aberdeen Asset Management Plc, in Lagos's Radisson Blu luxury hotel. He's one of 10 fund managers I'm trailing across frontier markets from Argentina to Myanmar to discover which will become the investment magnets of tomorrow. Daly believes that Nigeria—despite widespread violence, poverty made worse by corruption and the collapse in oil prices since the middle of last year—will with time become increasingly attractive to investors because of its large and growing population (now 177 million) and its abundance of natural resources.

Construction at **Eko Atlantic**, which is designed to become an oceanside business and residential complex

Nigeria topped my list of the 10 most-promising frontier markets for investors during the next five to 10 years, based on population, gross domestic product and other indicators as interpreted by the 10 fund managers on my tour. (Nigeria ranks 16th out of 19 countries in *Bloomberg Markets*' annual ranking of the most-promising frontier economies in which to invest, based on 19 criteria ranging from projected GDP growth to currency stability. See page 38.) This West African nation comes closer than other countries I visited to resembling high-growth economies such as Brazil, China and India. The United Nations forecasts that by 2050, Nigeria will overtake the U.S. as the world's third-most-populous country, behind India and China. Its economy, with a GDP of $521.8 billion in 2013, edged out South Africa's for the continent's top spot.

Daly and I need a car in a hurry for our first meeting of the day, so I haggle over the price with a driver. Before we can climb into his vehicle, though, a large woman blocks our path. "You cannot take this car," she screams, slamming the door almost onto my fingers. The driver leans across shouting: "Why you take my customers? Get away from them." Marching over to him, the woman says he shouldn't be here. With the passenger side clear and only a few minutes to make our meeting, we jump into the car. Before we can pull away, the woman lands a punch through

Zoology student **Samuel Pelumi** works on his laptop outside his home alongside the Lagos Lagoon.

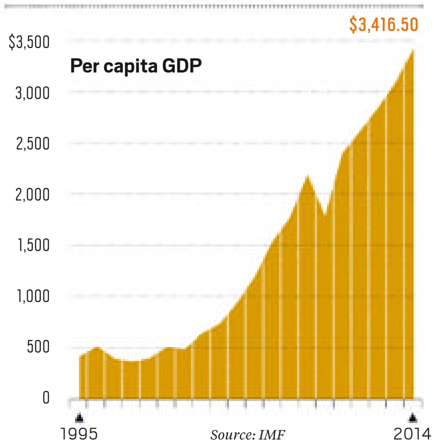
the open window on our driver. I have to restrain him from retaliating. "Did you see?" he says as we speed off. "She was pregnant, so it's lucky I didn't hit her." Our cabbie tells us the woman is part of a mafia that controls taxi ranks.

In Lagos, driving is a dangerous business. On another day, a policeman leaps into my taxi and punches my driver while the car is moving in an attempt to elicit a fine for something we didn't do: run a red light. Nigeria's roads are the fifth deadliest among 175 locales tracked by the World Health Organization. I can believe it. When I arrived here to do research for my book, I'd hoped to hire a driver I'd used on a previous visit—only to learn he'd been killed a month earlier when a car traveling in the opposite direction flipped onto his windshield.

Danger of another kind plagues the Nigerian capital, Abuja, 700 kilometers northeast of Lagos. When we visit, the city is on high alert due to the ever-present

MAKING HEADWAY

Compared with some of its neighbors, Nigeria has prospered under 16 years of democracy.



Source: IMF

threat from Boko Haram, an Islamist terror group whose name means Western Education Is Forbidden. In a single day last year, Boko Haram killed 75 people commuting into Abuja and abducted 276 schoolgirls, who are still missing. The group's targeting of the capital marks a ratcheting up of the insurgency that has claimed 13,000 lives in five years. On Jan. 10, in Boko Haram's stronghold of northeastern Nigeria, a suicide bomber described by onlookers as being a girl no more than 10 years old detonated explosives hidden under her veil, killing as many as 20 people, including the child. Days earlier, in a succession of attacks on towns in the north, Boko Haram militants killed hundreds of residents; estimates varied as to the number of victims.

In Abuja, we interview Sanusi Lamido Sanusi, who until February 2014 was governor of the Central Bank of Nigeria and is now the emir of Kano, the main city in northern Nigeria. "Boko Haram isn't really

a Muslim-Christian thing, because they've killed many more Muslims than Christians," he says. "When you have a system in which 90 percent lives in poverty, 70 percent in absolute poverty, you're likely to have one problem or another."

As central bank governor in 2009, Sanusi pushed out eight top bankers accused of corruption. Like Pelumi, the young zoology student, Sanusi tries to finds solutions to the problems in front of him. To alleviate poverty in the world's third-poorest country, he turned his attention in 2013 to tomatoes. Sanusi found they were mostly being left to rot in the fields, while imports of tomato paste—a staple ingredient for suya meat sticks flavored with hot chili and ground peanuts and sold on every main street—cost $360 million a year. A lack of storage facilities or food processors meant that tomato farmers would take whatever price they could get—or leave the fruit to decay.

Sanusi teamed up with industrialist Aliko Dangote, Africa's richest man and a fellow Kano native, to build a $25 million tomato paste factory that bought tomatoes at a fixed price from 8,000 farmers. With a contracted income, farmers were able to borrow to buy their seeds. The factory's output enables Nigeria to cut tomato paste imports by a third, Sanusi tells us—and ease the deprivation that has made the north fertile ground for Boko Haram recruiters.

Nigerian President Goodluck Jonathan ousted Sanusi from the governor's job after the central bank urged the president's office to investigate the disappearance of tens of billions of dollars in oil revenue that should have benefited the Nigerian economy. Sanusi was never charged with any wrongdoing. "The episode should remind investors that Nigeria's country risk is high," Aberdeen's Daly says.

Back on Lagos Island, we visit Dangote's headquarters, from which he presides over a vast enterprise stretching from cement to telecommunications to flour. All of this will be dwarfed by Dangote's next venture—oil refining—even with the beating that crude prices have taken, plunging from $107 a barrel in June to $47.43 as of Jan. 12. Oil accounts for 90 percent of Nigeria's exports. Most of the crude from the Niger Delta and offshore in the Gulf of Guinea is refined abroad before it returns to Nigeria as fuel. The country has four refineries, but pipeline theft, fires and neglect have reduced their output to a fifth of capacity.

Dangote, whose $23 billion personal fortune at the beginning of 2014 was slashed to $13.9 billion as of Jan. 13, thanks largely to oil's fall, is betting on Nigeria's future energy needs: He's spending $9 billion on a refinery and petrochemical plant in the Lagos area. Devakumar Edwin, chief executive officer of Dangote's cement business, tells us the refinery will produce 400,000 barrels a day beginning in 2017 and eventually reach a million barrels, which would make it the second-biggest refinery in the world.

Ngozi Okonjo-Iweala, Nigeria's finance minister, tells us she's been studying the finances of a Nigerian couple, Alhaji Kamoru Yusuf and his wife, Bolanle, to find out what's right and wrong with the economy. They took out short-term loans to progress from a roof-nail business to building Nigeria's first cold-roll steel mill in an effort to take business away from Chinese exporters. Like tomato paste and fuel, steel is a natural for Nigeria, where the government says more than 3 billion metric tons of iron ore lie untapped.

Alhaji and Bolanle succeeded, Okonjo-Iweala tells us, but she wants to make it easier for others to follow suit. What's missing in Nigeria, she says, is a state-backed development bank along the lines of Germany's KfW bank or Brazil's BNDES. "You can't expect people to borrow short term—for three years—to invest in a 15-year endeavor," she says. "There's a missing institution." Not for long. In December, the Abidjan, Ivory Coast–based African Development Bank approved a financial package of $500 million to support the establishment of the Development Bank of Nigeria.

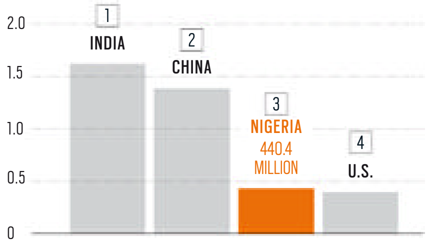
The country has launched a similar effort to boost home ownership. The government says Nigeria needs 17 million new homes, a deficit it says is growing by 2 million a year. Probably only 50,000 Nigerians have mortgage accounts, Okonjo-Iweala says. The Nigeria Mortgage Refinance Co. will operate along the lines of Fannie Mae in the U.S., selling long-maturity bonds to fund housing loans. This, Okonjo-Iweala says, will help prevent people in need of money from acquiring it through reckless borrowing or even engaging in criminal behavior. "If we can create this institution so a young couple just starting out knows that within 20 years they can buy their home, it helps curb any temptations to do the wrong thing," she says.

Peering into the future—beyond telecommunications, manufacturing and

PEOPLE POWER

Already Africa's largest economy, Nigeria is forecast to overtake the U.S. in population in 35 years.

Population projection for 2050 (in billions)



Source: United Nations

BLOOMBERG TIPS

Gauging Nigeria's Risks

You can use the Sovereign Credit Risk (SRSK) function to compare Nigeria's model-calculated probability of default with that of other African countries. Type **SRSK <Go>**, click on the arrow in the upper-left corner of the screen and select Middle East and Africa. As of Jan. 12, Nigeria had the sixth-lowest default probability, at 0.06 percent. For more details, click on the country's name. Type **GC NG <Go>** to use the Graph Curves function to display Nigeria's sovereign-debt curve. Type **COUN NGN <Go>** and click on the Economics tab for an overview of economic forecasts for the country. Type **OTC NGN <Go>** to monitor trading in Nigerian markets.

JON ASMUNDSSON

Students attend class at a ramshackle school in the Makoko slum in Lagos, Africa's largest city.

construction—Okonjo-Iweala sees growth coming from nonoil minerals yet to be exploited: zinc, copper, bitumen, tantalite and gemstones. Then there's Nigeria's best-loved industry: Nollywood. Measured by the number of movies made per year (not box office earnings), Nigeria's film industry ranks second only to India's Bollywood, with Hollywood trailing a distant third. "It's amazing to me," Okonjo-Iweala says. "When I'm in the Caribbean, people say: 'Are you Nigerian? We've been watching your movies.' The potential to service the black diaspora and beyond is amazing; we've only just begun to plumb that. Nigeria has the potential to be another California."

Of late, Nigeria has looked less like California than, well, Nigeria. Almost daily outbreaks of Boko Haram–inspired atrocities marred the run-up to the Feb. 14 presidential election pitting the incumbent Jonathan of the People's Democratic Party against former military leader Muhammadu Buhari of the All Progressives Congress.

In recent months, the election-related bloodshed and the oil price drop have led Daly to cut Aberdeen's holdings of Nigerian government bonds denominated in the local currency, the naira, to zero. Daly says the government's response to Boko Haram has been ineffectual. He's also worried about oil. "A further sustained collapse in the price of oil is by far the biggest risk," Daly says. He says the naira has weakened but not enough to make it attractive compared with the selloff in other oil-sensitive currencies such as the Russian ruble and Colombian peso. For the time being, Daly is investing in the nation's banks. The bonds of Nigerian lenders, including Zenith Bank Plc and Guaranty Trust Bank Plc, make up 2 percent of Aberdeen's emerging-markets corporate bond fund assets. That's double the weighting in the benchmark JPMorgan CEMBI Broad Diversified composite bond index.

In the longer term, Daly says, economic momentum should come from investment in oil production by Dangote and others. Daly says an improving economy will reduce public debt, increase foreign-currency reserves and strengthen other indicators that credit-ratings firms use to assess risk. As it stands, Nigeria has a long-term foreign-debt rating three levels below Standard & Poor's investment-grade category. Daly is betting that will change for the better. "Nigeria is the one country in Africa you could see having its credit rating increased to investment grade over the next 10 years," he says.

Gavin Serkin is an emerging-markets editor-at-large at Bloomberg News in London. gserkin@bloomberg.net
This article is adapted from *Frontier: Exploring the Top Ten Emerging Markets of Tomorrow* (Wiley/Bloomberg Press, February 2015).

AFRICA: BEYOND THE CLICHÉS

BY EDWARD ROBINSON

BILLIONAIRE MO IBRAHIM IS COMPILING THE FACTS HE SAYS INVESTORS NEED TO MAKE SMART CHOICES AMONG DIVERSE COUNTRIES. TOPPING HIS LIST: MAURITIUS.

MO IBRAHIM, a Sudanese-born billionaire philanthropist, says the Ebola outbreak in West Africa has once again painted the entire continent as a disaster zone. It's a perception he's been working to dispel since selling his African mobile-phone network for $3.4 billion in 2005 and founding the Mo Ibrahim Foundation to promote honest and accountable government. His primary tool: data.

The Ibrahim Index of African Governance measures how well nations are developing their economies, safeguarding rights and guaranteeing the rule of law. Researchers synthesize information from 34 sources, including the International Monetary Fund and African Development Bank. Atop the 2014 list: Mauritius. On the bottom: Somalia.

"The Ibrahim indices have become benchmarks of governance in Africa and important tools for investors and risk managers," says Hendrik du Toit, chief executive officer of Investec Asset Management, a firm that originated in South Africa and is now based in London. Ibrahim, 68, spoke with *Bloomberg Markets* about the challenges and opportunities of investing in the second-most-populous continent.

LURCHING BETWEEN EXTREMES

There is a tendency to make general judgments—"Africa is a basket case," or "Africa is rising." We always lurch from one extreme to the other. What people need to do is spend a little time looking at the granularity of what's happening in Africa. If you go to some parts of the Congo, you might say, "This is jungle; this is ungovernable." Other countries are fracturing—look at what's happening in Libya. That's a complete failure.

Go to other nations, such as Botswana or Mauritius, and you'll see a pleasant place with a sensible government. Namibia is a very well-run country. It's huge, with a lot of potential resources, and it has good roads and railways. This is a country investors should look at.

EBOLA SUCCESSES

Senegal and Nigeria managed to control the situation. The federal government and the state government of Lagos played an important role. We saw civil society play a major role, and Nigerian business. It shows what can be achieved when society comes together in a moment of real unity.

The battle is also in dealing with traumatized communities. Liberia, Sierra Leone and Guinea are each coming out of conflicts. An initiative must address how to make these countries more resilient to handle the next outbreak.

RELIABLE DATA

With the data collected over the last 10 years, we hope academics are able to troll through and discern the key drivers. We need to understand the links between security and development or between education and development or between human rights and development. These questions can be answered only by getting reliable data; otherwise, it becomes a discussion dominated by polemics and ideological differences. I love Africa and have always been gunning for people to invest. I prefer to be an African realist. To do that, we need facts.

AFRICA'S BEST-GOVERNED NATIONS

Island nations Mauritius, Cape Verde and the Seychelles get high marks for governance in Ibrahim's index. Conflict-torn Somalia ranks at the bottom.

	1 MAURITIUS	2 CAPE VERDE	3 BOTSWANA	4 SOUTH AFRICA	5 THE SEYCHELLES
SCORE	81.7	76.6	76.2	73.3	73.2
Safety and rule of law	84.5	78.2	85.3	68.1	70.8
Participation and human rights	77	83.5	73.1	74.4	74.1
Sustainable economic opportunity	79.7	63.1	65.9	71.9	63.6
Human development	85.6	81.6	80.4	78.8	84.4

SAFETY AND RULE OF LAW Strength, accessibility and transparency of legal system

PARTICIPATION AND HUMAN RIGHTS Openness and integrity of political process

SUSTAINABLE ECONOMIC OPPORTUNITY Conditions for business development

HUMAN DEVELOPMENT Commitment to education and cultural institutions

Edward Robinson is a senior writer at *Bloomberg Markets* in London. edrobinson@bloomberg.net

PHOTOGRAPH BY MATHIAS BRASCHLER AND MONIKA FISCHER


ISTANBUL
FRANKFURT
Jackson Pollock
JEUNE AFRIQUE
Intérieurs parisiens
FUTURSHOW

This terminal just got better
104) New Search
105) Actions
106) Settings
107) Feedback
Research
All Research
Topic
Sector
Time
Page
Narrow Search
Source All All
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2) 10:32 Market Sustains the Bearish Mood ...volume and v... Forecast/O... Meristem Secu... 5p
3) 09:59 The HY Wire: Extension tension Forecast/O... BofAML 19p
4) 13:31 KRO,K... Fitch Rates Kronos Worldwide's Proposed Sr. Sec. T... Issuer Fitch Ratings 12p
5) 08:34 AC PM... [Delayed] Philippine Strategy Flash: Inflation cre... Instant Ana... JP Morgan 8p
Sovereign Rates
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14) 13:51 7011 JP [Delayed] Mitsubishi Heavy Industries (7011): 3Q... Issuer JP Morgan 12p
15) 08:31 Fitch Downgrades Brooklands 2004-1 Issuer Fitch Ratings 8p
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16) 12:40 Fitch Takes Actions on Multi-Issuer Cedulas Hipotec... Issuer Fitch Ratings 4p
17) 13:24 Fitch Affirms 5 Classes of Hamlet II, Ltd./LLC Issuer Fitch Ratings 16p
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Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2014 Bloomberg Finance L.P.
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Cyprus Calling

Two years after a financial crisis, the island's biggest banks are luring investors from New York and Moscow. One of their biggest challenges: a torrent of bad loans.

By Maria Petrakis

Photographs by Michal Chelbin

Haris Georgiades's day started with a protest and ended with a party. ¶ On the morning of Nov. 20, the finance minister of Cyprus attended a Bank of Cyprus Pcl shareholder meeting at which Josef Ackermann, a former head of Deutsche Bank AG, was elected chairman as several hundred protesters complaining about the loss of their savings tried to force their way in. Later, Georgiades changed into jeans for a screening at a movie theater in Nicosia of *Fury*, a World War II tank epic starring Brad Pitt. The Moet & Chandon was flowing, as Victor Kislyi, the 38-year-old Belarusian founder and chief executive officer of Wargaming Pcl, mingled with members of the board of Hellenic Bank Pcl, in which Wargaming owns a 26 percent stake. ¶ Almost two years

after a banking crisis on the divided Mediterranean island threatened the existence of the euro, an unusual array of investors, including U.S. billionaires Wilbur Ross and Daniel Loeb;

Hellenic Bank Chairwoman Irena Georgiadou at the firm's headquarters in Nicosia

Viktor Vekselberg, Russia's second-richest man; and Kislyi, are buying stakes in Cypriot banks. Ross and Vekselberg are backing Bank of Cyprus, the country's biggest lender, while Loeb's Third Point Hellenic Recovery Fund owns 27 percent of Hellenic Bank.

The flurry of activity marks a renewed interest in the country after a 10 billion euro ($11.6 billion) rescue by the European Union and the International Monetary Fund deflated a financial industry that had ballooned to seven times the size of the country's economy. While banks are still hobbled by capital controls and nonperforming-loan ratios in excess of 50 percent, the investors share a conviction that Cyprus, an EU nation closer to Beirut than Brussels, is on the cusp of a recovery after what the IMF called one of the largest banking collapses on record.

Loeb is betting the best way to invest in that recovery is through Hellenic Bank, the island's second-biggest lender, which didn't require a bailout or seize customer deposits. "We are a small bank, but we are the only systemic bank that has not been bailed in or bailed out," says Irena Georgiadou, the bank's 38-year-old chairwoman, sitting in an office at Hellenic Bank headquarters in Nicosia on the day of the screening, talking over the peal of church bells. "We are maybe the right proxy for the recovery of Cyprus."

Cyprus, the second-smallest economy in the 19-nation euro zone, with a population of 1.1 million, is poised to expand 0.4 percent this year, the IMF estimates, after shrinking 3.2 percent in 2014. "It's making a much faster rebound than the much bigger crisis economies of Greece, Portugal, Spain and Italy," says Christian Schulz, senior economist at Berenberg Bank in London. "It's more likely than the other southern European crisis countries to do what Estonia and Latvia did: take the pain up front, do the reforms necessary, helped by the fact that they are small."

At the crossroads of the Middle East and Europe, Cyprus has been overrun for centuries by empires and armies: Assyrians, Persians, Greeks led by Alexander the Great, Venetians and, for three centuries, the Ottoman Empire, the precursor of modern-day Turkey. The country gained independence in 1960 after almost a century of British colonial rule, only to erupt into violence between Greek and Turkish Cypriots. A Turkish invasion following an Athens-backed coup seeking to unite the country with Greece led to a division of the island in 1974 that's still in effect.

Banking, along with tourism and shipping, buoyed economic growth after the division. The island's reputation as a financial center was boosted during the Lebanese civil war from 1975 to 1990, when wealthy Middle Easterners abandoned Beirut for Nicosia. After the fall of the Berlin Wall, Russian and eastern European businesses moved to Cyprus, which offered low corporate tax rates, a legal system based on British law and strict bank-secrecy rules.

Wargaming was one of them. Kislyi began developing online games with his college friends while studying physics and computer science at Belarusian State University in Minsk in 1995. In 2010, a year before incorporating his business in Cyprus, he tapped a lucrative seam with World of Tanks, in which multiple players destroy virtual replicas of mid–20th century Soviet, German and U.S. armored vehicles. The company, which says its games have 110 million registered users, reported profit of €24.6 million on sales of €234 million in the first six months of 2013, the last period for which it has released results.

While Wargaming's business was booming, Cyprus was sinking. The restructuring of Greece's €200 billion of privately held debt in 2012, the largest such move in history, left the island's banks, big holders of that country's sovereign bonds, with €4.5 billion in losses. Germany, which had contributed the most to saving indebted euro-zone states, balked at bailing out rich Russians with money in Cyprus. Russia, which had given Cyprus a €2.5 billion loan, declined to throw another lifeline.

That's when the European Central Bank and the IMF told Cyprus the only way it would get the money it needed for a bailout was to seize deposits at the two largest banks and convert the funds into equity, the first time such a tactic had been used in the euro zone. In March 2013, Bank of Cyprus acquired most of the assets and loans of Cyprus Popular Bank Pcl, then the second-biggest lender, and seized almost half of the savings of 21,000 customers. Shareholders of both banks were almost wiped out.

Victor Kislyi, founder and CEO of Cyprus-based video game company Wargaming, which owns a stake in Hellenic Bank

COURTESY OF SLAVA PATALAH/WARGAMING

LEFT TO RIGHT: SIMON DAWSON/BLOOMBERG; BEN BAKER/REDUX; BELINSKY YURI/ITAR-TASS PHOTO/CORBIS



Billionaires, from left, Daniel Loeb, Wilbur Ross and Viktor Vekselberg invested in Cyprus banks after a financial crisis in 2013 threatened the existence of the euro.

The deposit seizure at Bank of Cyprus affected Wargaming, which recorded an impairment charge of €8.2 million.

Restrictions were imposed on moving money abroad, the only such capital controls in the euro area and still in place, leaving Russian and other depositors with money captive in Cypriot banks. Kislyi, who declined to be interviewed for this story, echoed the concerns of many about the fate of Cyprus as a business and offshore center when he warned in a July 2013 speech to Wargaming shareholders that if the country's economic woes led to higher taxes, his company might move to a more attractive jurisdiction.

Then the Americans arrived. Loeb, 53, known for his vitriolic critiques of executives of Sony Corp., Yahoo! Inc. and other companies in which he acquired stakes, had bought Greek sovereign bonds on a bet shared by only a few that the euro area would continue to support the country. Third Point Offshore Fund, his firm's biggest hedge fund, rose 21 percent in 2012 on the investment. In April 2013, Loeb, a former distressed-debt analyst at Jefferies Group LLC and high-yield-bond salesman at Citigroup Inc., started Third Point Hellenic Recovery.

In November of that year, the fund made its first and only banking investment in either Greece or Cyprus, acquiring a stake in Hellenic Bank and diluting control of the Church of Cyprus, which had co-founded the lender in 1976 to help finance an economic recovery after the Turkish invasion. It was the first foreign direct investment in the country since capital controls had been imposed and, along with a similar infusion of capital from Wargaming, enabled the bank to avoid taking state aid or seizing customer deposits. Loeb and a spokesman for the fund declined to comment. Shares fell 13.6 percent from the date of his investment on Nov. 1, 2013, through Jan. 12.

Not being tainted by the stigma of a bail-in is "definitely a key driver of business" for the bank and one reason Wargaming invested €40 million, says Vangelis Georgiou, 45, the video game company's general manager, sitting in a 19th-century house with ceramic-tile floors that serves as the firm's headquarters.

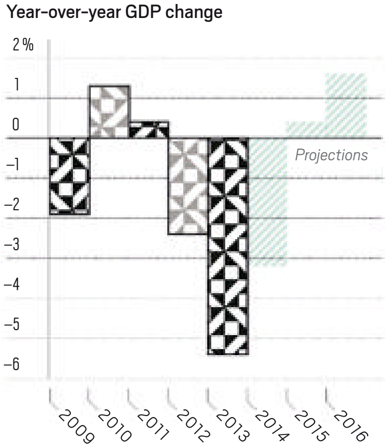
The building, where palm trees tower in the courtyard and employees are locked in combat on their laptops, is a short distance from an 11-story skyscraper that Wargaming bought for €11.8 million in January 2014. Still shrouded in green netting and scaffolding in December, and festooned with banners announcing the company's new global headquarters, it's the clearest sign that Kislyi's concerns about Cyprus have abated.

Hellenic Bank's share of the island's deposits increased in the second quarter of 2014 to 12.6 percent from 11.8 percent in 2013, compared with a drop to 25.5 percent for Bank of Cyprus, according to central bank data. At the end of September, the share had risen to 13.4 percent. With those deposits, Hellenic Bank aims to expand as lending growth recovers, says Georgiadou, the first woman to run a commercial lender in the country. "We have the liquidity, we have the support of the

CYPRUS RISING

The island's economy is poised to recover after a banking crisis in 2013 led to a contraction of more than 5 percent.

Year-over-year GDP change



Source: IMF

A wall in Nicosia marks the dividing line between the Greek-Cypriot and Turkish-Cypriot parts of the Mediterranean island.

shareholders, the capital and the ambition, and we want to be the bank that will finance this recovery," she says.

The bank also has a mountain of nonperforming loans to work through: 56 percent of its total loans as of Sept. 30, up from 46 percent at the end of 2013. It reported losses of €124.8 million for the first nine months of last year amid falling property prices and a contracting economy.

Georgiadou, a former PricewaterhouseCoopers LLP accountant and chief financial officer of Cyprus-based online-betting firm Megabet Ltd., has firsthand experience of how banks were sacrificed to save the economy. As an adviser to then–Labor Minister Georgiades during the March 2013 crisis, she says, she burst into tears when they learned the only choice was to seize deposits after the government failed to get funds from Russia. "We were thinking there must be something somewhere, some button to press to fix everything," she says.

Now that she's running Hellenic Bank, there's still no magic button. The bank's fate rests on an economic recovery, and that depends in part on what happens to Greece, Cyprus's biggest trading partner, and Russia, which still looms large in the country, even after many wealthy Russians lost their savings there. Service exports to Russia, mostly tourism, account for more than 20 percent of Cyprus's total, a figure that probably will fall as fewer Russians travel abroad after a 46 percent drop in the value of the ruble against the dollar last year. "With the depreciation in the ruble, there is certainly some further pressure on whether Cyprus can come out of recession," says Bank of Cyprus CEO John Hourican.

In December, Russian President Vladimir Putin, citing the seizure of deposits in Cyprus and Western sanctions imposed after his country's annexation of Crimea, urged Russian businesses to repatriate funds from abroad. That could hurt Hellenic Bank, where Russian deposits account for 24 percent of the total, according to an investor presentation. It could also have a devastating effect on the island's economy, the IMF says.

Greece, where unemployment remains above 25 percent and elections have revived talk of an exit from the euro zone, doesn't offer better prospects, though Cyprus banks are less exposed now to Greek debt. "Important partners of Cyprus are all—in particular, Greece—not the kind of country you want to bet your recovery on,

Josef Ackermann, a former CEO of Deutsche Bank, became chairman of Bank of Cyprus in November.

BLOOMBERG TIPS

Analyzing Bank Bonds

You can use the Fixed Income Search (SRCH) function to find bonds issued by Cyprus-based banks. Type **SRCH <Go>**, enter *CYPRUS* in the field and click on the Country of Domicile item in the list of matches. Next, enter *FINANCIALS* and click on the Sector/Industry Group match. Then click on Results. On the Results screen, click on the Analysis button on the red tool bar and select FI Worksheet (FIW). Click on the Graph tab. Click on the arrows to the right of Plot to select metrics to chart. Right click on a bond in the scatter plot and select YAS to display it in the Yield and Spread Analysis function. As of Dec. 12, a Hellenic Bank bond paying a 10 percent coupon yielded 16.8 percent. JON ASMUNDSSON

BOTTOM: EVENTPRESS HOENSCH/DPA/CORBIS

but Russia is clearly the biggest, most imminent risk," says Schulz, the Berenberg Bank economist. "Russia is definitely the Achilles' heel there."

The island's division also is a continuing risk. The discovery of offshore natural gas deposits—cited by investors, including Ross, as a selling point for Cyprus's long-term outlook—is complicated by tensions with Turkey. Unification talks between the two sides of the island, which make up the nation that belongs to the EU, were called off in November after Turkey dispatched ships to search for gas in Cypriot waters.

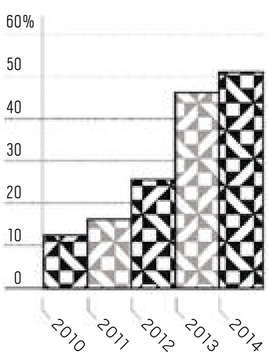
Even if Hellenic Bank withstands these shocks, it will have to contend with a bigger competitor. Bank of Cyprus, backed by Ross and Vekselberg, reported a profit of €76 million in the first nine months of last year. Ackermann, 67, the new chairman, is a formidable presence in the European banking industry. "Very few of these severely impacted banks return to profitability as quickly as did Bank of Cyprus," says Ross, 77, who made money investing in Bank of Ireland Plc. Vekselberg and Ackermann declined to comment.

Chrysostomos II, the archbishop of the Church of Cyprus, whose stake in Hellenic Bank, which it co-founded, has been reduced to 3.6 percent

AWASH IN BAD LOANS

A surge of soured loans threatens to erode profitability at banks in Cyprus, which has been in a recession since 2012.

Nonperforming loans* as a percentage of total loans



**Loans that have been in arrears for more than 90 days as well as restructured loans that, at the time of restructuring, had been in arrears for more than 60 days.*
Sources: Central Bank of Cyprus, IMF

Bank of Cyprus, where about half the loans are souring, still has much to do to restore confidence among customers who lost their savings. Just as Hourican was telling shareholders at the annual meeting in November that his company had to "recover the lost trust between the bank and society," police were holding back protesters. "You seized my savings," one of them shouted. "Now you want to seize my house?"

Georgiadou is betting Hellenic Bank can capitalize on steering a different course. "Hellenic Bank managed to find investors," she says. "It was a time when Cypriots were lining up outside banks, taking out their money, and there you go, you have private investors, they see the macro story, they see the balance sheet, and they put real money in the bank."

The investments by Loeb and Kislyi, while they may have saved Hellenic Bank, are a bittersweet blessing for Chrysostomos II, the archbishop of the Church of Cyprus. His church, once one of the island's biggest investors, has seen its stake in Hellenic Bank dwindle to 3.6 percent and dividend income from Cyprus banks dry up, forcing cutbacks in social and philanthropic programs.

"They wanted to punish the old shareholders," says Chrysostomos, 73, sitting in front of an icon of a stern Christ in a cavernous palace in Nicosia. "That's why I'm no longer interested in the chapter called banks."

Maria Petrakis is a reporter-at-large at Bloomberg News in Athens. mpetrakis@bloomberg.net With assistance from **Georgios Georgiou** in Nicosia.

WANG JIANLIN

IS READY FOR HIS

CLOS

CHINA'S COMMERCIAL REAL ESTATE KING
HAS IT ALL SCRIPTED OUT:
HE'S GOING TO BE THE BIGGEST NAME IN THE GLOBAL MOVIE INDUSTRY.

BY **ZIJING WU** AND **WILLIAM MELLOR**

G	GENERAL AUDIENCES

RECLINING IN A BEIGE LEATHER seat in his Gulfstream G550 private jet, Wang Jianlin barks an unlikely order as the aircraft descends into a remote pocket of Southwest China.

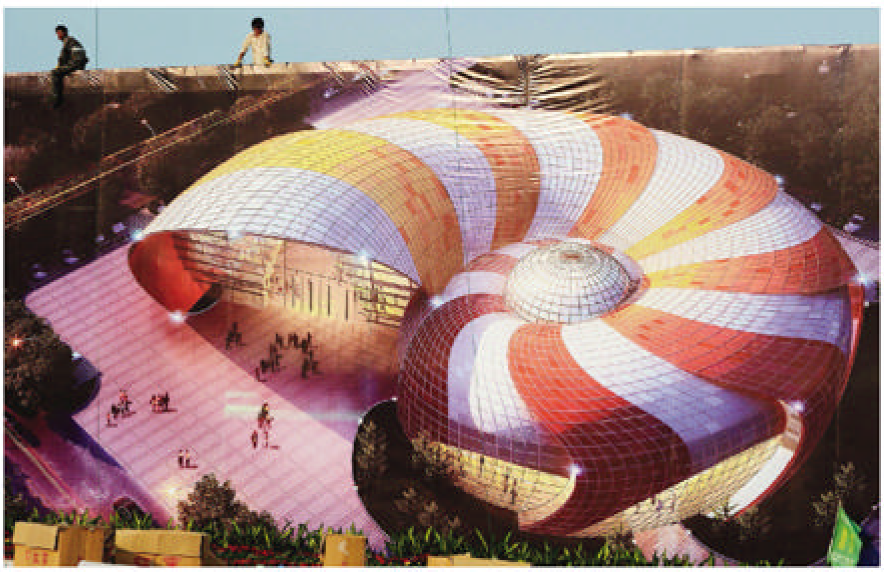
From Beijing to Hollywood to London and elsewhere in his expanding property, film and entertainment empire, Wang, the billionaire chairman of Beijing-based Dalian Wanda Group Co., is known as a stickler for formality. Not only does he favor dark business suits and ties, he empowers his receptionists to fine employees who fail to meet his dress standards. Today, though, China's second-richest man is clad in khaki pants and sneakers. And as the jet prepares to land in China's poorest province, Guizhou, he instructs his entourage to follow his example. "This is a trip to lift poverty," Wang tells them. "Suits are not appropriate."

Swiftly, all jackets are discarded.

Despite Wang's efforts, his reception on the ground is anything but casual. Local officials in pressed black suits stand to attention in a piercing December wind. A police escort clears roads for his motorcade. As he approaches the hardscrabble city of Danzhai (population 170,000), neon signs along the four-lane main street flash the message, "Warmest welcome to Chairman Wang." It's the kind of treatment typically reserved for visiting government ministers. And though Wang, 60, has no political rank, he has rapidly growing financial clout, in China and abroad.

In the leadup to the December initial public offering of one of Dalian Wanda's listed units and the January IPO of another, Wang's fortune jumped more than 60 percent to $24.6 billion, according to the Bloomberg Billionaires Index. That moved him closer to China's richest man, Alibaba Group Holding Ltd.'s Jack Ma, who was worth $27.3 billion as of Jan. 15.

Wang's empire had revenue of $40 billion in 2014. He controls the world's largest chain of movie theaters, measured by number of movie screens, and the second-largest commercial property company, measured by leasable floor space. Wanda's malls, offices and luxury hotels boast a total floor space of 93.5 million square meters (1 billion square feet), 1½ times all the leasable space in Manhattan. Among the marquee projects: Western Europe's tallest residential building, One Nine Elms, in London; and Qingdao Oriental Movie Metropolis, which upon completion in 2017 will be the world's biggest movie studio and theme park. For the studio's 2013 groundbreaking ceremony, in the Chinese coastal city of Qingdao, Wang flew in Nicole Kidman, Leonardo DiCaprio, John Travolta, Catherine Zeta-Jones,



Nicole Kidman, above, brings glamour to the groundbreaking for the **Qingdao Oriental Movie Metropolis**. Right, an outsize artist rendering of one piece of the complex.

PREVIOUS SPREAD: TOMOHIRO OHSUMI/BLOOMBERG; THIS PAGE, TOP TO BOTTOM: TOPPHOTO VIA AP IMAGES; IMAGINECHINA VIA AP IMAGES

Ewan McGregor and Kate Beckinsale to provide star power.

In lesser deals, Wang has also snapped up a British yacht manufacturer, Sunseeker International Ltd., and bought a 20 percent stake in Atletico Madrid, the reigning Spanish football champions.

Wang has even taken a shot at helping tackle one of China's most intractable challenges: narrowing the wealth gap between the rural poor and the country's new rich such as himself. Hence his appearance at Danzhai, where far from treading the red carpet with Hollywood royalty, he trudges through pigsties while talking up the $160 million worth of philanthropic investments he has planned. Wang hopes his efforts, which include awarding scholarships and building food-processing plants, will double the living standards of 2 million farmers in the next five years.

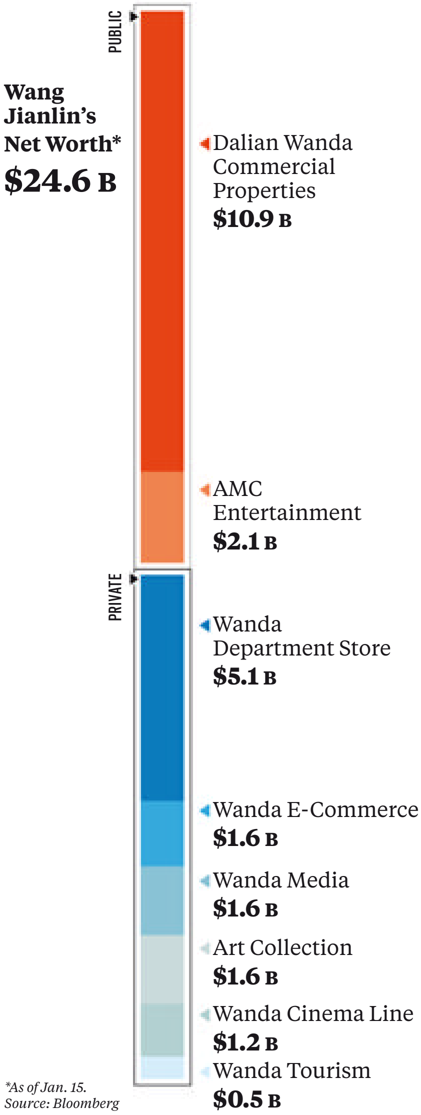
The tycoon visits a crumbling hovel inhabited by Huang Jinhe and his family. There, surreptitiously, Wang has his personal assistant slip a wad of cash to the 64-year-old farmer: 10,000 yuan ($1,600), the equivalent of two years' income for the Huangs.

WANG, A FORMER SOLDIER in the People's Liberation Army who still retains a ramrod-straight military posture and close-cropped hair, made his first pot of gold developing real estate in Dalian, a northeastern coastal city. Then he started buying up movie theaters across China. In 2012, he began producing and distributing locally made films, including the English-language *Man of Tai Chi*, directed by Keanu Reeves, star of the *Matrix* movies.

That same year, he paid $2.6 billion plus debt to acquire AMC Entertainment Holdings Inc., the second-biggest U.S. cinema operator. Now, he says, he's in talks to buy a majority stake in Lions Gate Entertainment Corp., the Hollywood studio that made the *Hunger Games* films. And he says he's also keen to invest in Metro-Goldwyn-Mayer Inc., producer of the James Bond and Hobbit franchises.

In readiness for those deals, and deals to come, Wang in September paid $1.2 billion for land on Wilshire Boulevard in Beverly Hills, California, on which he says he will build the headquarters of his nascent U.S. movie empire. As Wang tells it, U.S. movie studios are falling over themselves to sell stakes to him. "Many people come knock at my door, but Wanda is only interested in the big players and we want control," Wang says.

BUILDING BLOCKS



*As of Jan. 15.
Source: Bloomberg

Spokesmen for Lions Gate and MGM declined to comment on any discussions. Wang, however, is less reticent. Cocooned in the wood-paneled luxury of his Gulfstream, he describes his Hollywood strategy as key to transforming Dalian Wanda from a company heavily dependent on China's volatile property market into a more-diversified global business empire. "I give myself six more years to make Wanda a world-class company in the league of Microsoft and Wal-Mart," Wang says while devouring a simple breakfast of plain congee (rice porridge) and corn accompanied by a bowl of fresh cherries.

More specifically, Wang says that by 2020 he wants to increase revenue by 2½ times to $100 billion—equivalent to the current annual sales of International Business Machines Corp. His target for net profit is $10 billion, more than Coca-Cola Co.'s estimated earnings for 2014.

Last year, 70 percent of Wanda's revenue came from its property arm. By 2020, Wang aims to reduce that dependence to 50 percent, with much of the rest of his income coming from the burgeoning Chinese film industry, which is now the world's second largest by box office receipts, surpassed only by Hollywood.

China's movie box office is growing at 40 percent annually and in 2014 came to an estimated $4.9 billion, according to the Chinese Film Producers' Association. By contrast, U.S. theater takings rose just 1 percent in 2014, to $10.9 billion. If that trend holds—and Wang predicts it will—China will overtake the U.S. as the world's biggest movie market by 2017. Buying Hollywood studios, Wang says, will give him the expertise, content and distribution he needs to conquer that market.

"Wang has a great thesis," says David Tawil, president of Maglan Capital, a New York–based hedge fund that owns about 1 percent of MGM. "We all know the boom-and-bust cycle that occurs in property markets, and it could be particularly bad in China. Wang knows it the best. It's wise of him to be diversifying away."

The U.S. motion-picture industry, however, may not be entirely convinced. "Everyone respects that Wang has the clout and money," says Robert Cain, president of Santa Monica, California–based Pacific Bridge Pictures, an industry adviser that counts Universal Studios Inc. and China

Film Group Corp. as clients. “But there’s a healthy degree of skepticism in Hollywood regarding Chinese money because there hasn’t been much delivered, only big talk.”

Tawil says Wang could change that. “His AMC purchase in 2012 makes him the most credible buyer,” Tawil says.

AMC has made Wang a popular man among U.S. equity investors. He bought the company outright and then sold roughly 20 percent of it in a New York IPO in late 2013. The stock rose 29 percent in 2014.

Wang has gone back to the IPO market twice since the AMC sale. His flagship, Dalian Wanda Commercial Properties Co., made an unspectacular debut in Hong Kong on Dec. 23. On Jan. 22, however, Wanda Cinema Line Co., which operates 14 percent of the movie screens in China, soared 44 percent on the Shenzhen exchange.

SHOULD WANG INDEED END UP owning a Hollywood studio, he could find worse story lines than his own rise from boy soldier to billionaire.

The son of a Communist guerrilla who fought alongside Mao Zedong on the Long March, Wang decided at age 15 to follow his father into the army—in part because in those harsh times, soldiers received slightly larger rations of rice and oil than their civilian comrades.

He was dispatched to China’s wild and windswept northern frontier with Russia, where the two erstwhile Communist allies, by then bitter rivals, were fighting a bloody border war and the only entertainment was one propaganda film a week.

Wang rose through the ranks to become a battalion commander before he left the army at age 32, a surprise to friends, who thought he had a good shot at becoming one of the top brass. “It was no longer wartime,” Wang says. “The slogan changed from ‘Ready for war any time’ to ‘It’s all about economy.’ It was crystal clear to me where I should be going.”

Following his discharge, Wang worked for the local government in Dalian for two years before taking over a near-bankrupt state-owned property company that was 6 million yuan in debt. “The government was freaking out and said whoever can turn it around will get the company for free,” Wang says. “I thought to myself, If I get some bank loans and land, it should be possible.”

Business deals in China have for millenniums been oiled by *guanxi*—a term meaning connections or relationships. Wang says he tapped connections made during his army career to secure loans, then convinced the Dalian government to sell him land where malodorous slums were clustered. He redeveloped it, paid off all the debt and made his first 10 million yuan.

As his empire grew, he says, he figured out better ways to maintain relations with local authorities in cities where his signature Wanda Plaza shopping malls are located. “We tickle the right spot,” Wang says. “Government wants to show political performance, so we give them a fair share of the profit in taxes and help solve their problems like employment.”

Wanda in turn benefits because it receives subsidies for culture-related projects such as entertainment parks with film

RACE TO THE TOP

The richest people in mainland China. Wang and Ma traded positions on the list in 2014.

1

JACK MA
$27.3 B
Founder of Alibaba Group

2

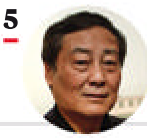
WANG JIANLIN
$24.6 B
Founder of Dalian Wanda Group

3

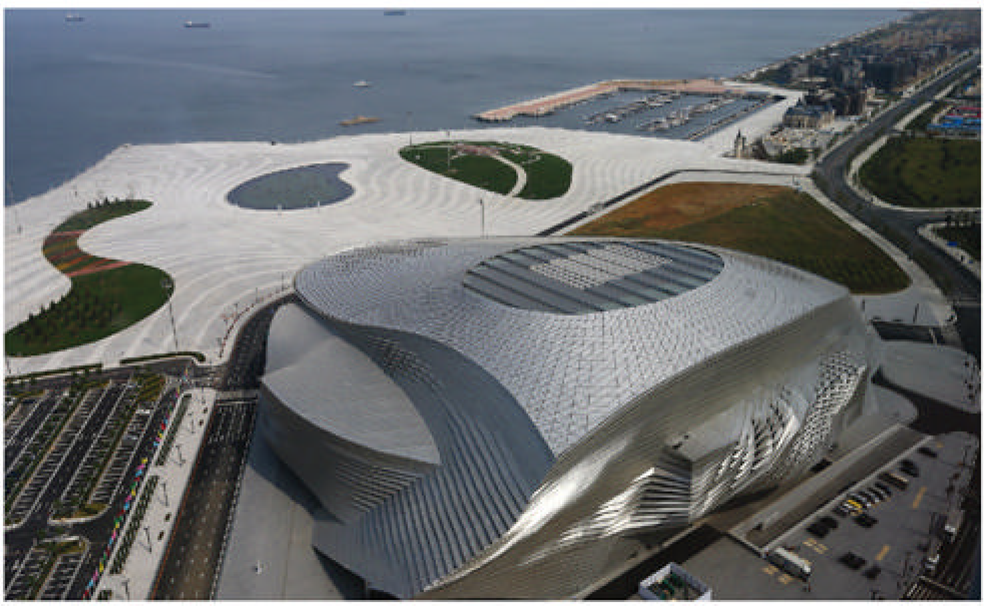
MA HUATENG
$16.1 B
Chairman of Tencent Holdings

4

ROBIN LI
$15.7 B
Founder of Baidu

5

ZONG QINGHOU
$11.2 B
Chairman of Hangzhou Wahaha

**As of Jan. 15. Source: Bloomberg*



Wang’s Chinese real estate portfolio includes the **Dalian International Conference Center**, left, the **Wuxi Wanda Cultural Tourism City Exhibition Center**, opposite top, and **Wanda Movie Park** in Wuhan.

TOP TO BOTTOM: BRENT LEWIN/BLOOMBERG; TOMOHIRO OHSUMI/BLOOMBERG; JEROME FAVRE/BLOOMBERG; NELSON CHING/BLOOMBERG (2); TOMOHIRO OHSUMI/BLOOMBERG

or historical themes. Wanda Group received 7.9 billion yuan in government subsidies in the 3½ years through June 2014, according to Wanda Commercial's IPO prospectus. "Wang leverages his cultural projects to get support from provincial and municipal government," says Peter Schloss, a partner at Beijing-based Phoenix Media Fund, which invests in China's entertainment sector. "That way, he gets government subsidies and land."

It wasn't always such a smooth ride for Wang. After Bo Xilai, a high-ranking Chinese official subsequently jailed for corruption in 2012, became mayor of Dalian in the 1990s, Wanda's business suffered because it wouldn't pay bribes, according to Wang.

"I was quite depressed. For a few years, I could only buy land secondhand from other people," Wang says. "We still made money, but it wasn't a pleasant time."

As he tells it, his bad relationship with Bo forced Wanda to do a growing share of its business outside Dalian. By 2008, he had moved the company headquarters to Beijing.

HIGH ABOVE THE PATCHWORK rice paddies of a country whose borders he once fought to defend, Wang pauses to reflect on how, almost 30 years after leaving the army, he still savors the discipline and simplicity of military life. One legacy is an employee code of conduct difficult to imagine elsewhere. Wanda's receptionists are nicknamed the dress police, because they keep a marking sheet of staff who don't turn up in the de facto company uniform of a dark suit with a light-colored shirt for men and a below-the-knee skirt for women. Violators have 100 yuan deducted from their salary for each breach.

TOP TO BOTTOM: JI HAIXIN/IMAGINECHINA; IMAGINECHINA VIA AP IMAGES

BLOOMBERG TIPS

Mapping Dalian Wanda

You can use the Relationship Map (RMAP) function to get a high-level overview of a selected company. Type **3699 HK <Equity> RMAP <Go>** on the Bloomberg Professional service to display such a map for Dalian Wanda Commercial. The map displays 12 types of information, or data nodes, for a selected stock. Click on the plus sign at the center of the Indices node to display more information about the benchmarks that Dalian Wanda Commercial is included in. To return to the main view, click on the minus sign to the right of the Indices table. RMAP also includes links to related functions for deeper analysis. Click on Analysts, for example, to display the Analyst Recommendations function. JON ASMUNDSSON

Unlike many Asian tycoons, who work until they drop, Wang says he will retire in six years, to devote himself to philanthropy and help turn China's notoriously underperforming national soccer team into a globally competitive outfit.

His only son, Wang Sicong, owns 2 percent of the company. However, Wang says he hasn't decided on a succession plan and will eventually donate most of his holding in Dalian Wanda to charity. "I don't need that much money," he says. "It's never about the wealth but the process of pursuing wealth. As long as the process is thrilling, the numbers in the end don't matter."

Zijing Wu covers billionaires at Bloomberg News in Hong Kong. zwu17@bloomberg.net **William Mellor** is a senior writer at *Bloomberg Markets* in Sydney. wmellor@bloomberg.net

THE

Caffein

Photograph by SAM KAPLAN

by David de Jong *and* Matthew Boyle

e Fix

JAB, the investment firm managing the $14 billion fortune of a reclusive Austrian family, is diversifying from luxury brands with an assault on the global coffee market.

Models and actors descended on New York's Cipriani Wall Street restaurant last May, Georgia May Jagger, Chris Tucker and Victoria's Secret Angel Doutzen Kroes among them. The real

VIP in the ballroom was someone few people would recognize. He's Peter Harf, first among equals in a trio of executives who manage the $14 billion fortune of Austria's Reimann family. The closely held investment firm Harf runs as senior partner, Luxembourg-based JAB Holding Co., widely known as JAB, is plotting a massive challenge to Switzerland's Nestle SA in the global coffee industry.

The occasion this evening in Manhattan was the annual gala for Delete Blood Cancer DKMS, the foundation Harf co-founded after the death of his first wife in 1991. The guests represented Harf's many worlds. Byron Trott, chairman of investment and advisory firm BDT Capital Partners, had enlisted his billionaire clients to invest in JAB's coffee deals. Executives from JAB-controlled Coty Inc., seller of namesake fragrances for David Beckham and Jennifer Lopez, were making the rounds. Others sported Jimmy Choo pumps, a JAB brand made famous in *Sex and the City*.

These days, Harf, 68, has his mind on a business far less glamorous than rock star perfumes and $2,995 crystal-encrusted stiletto heels. On May 7, the day of the gala, he and JAB partners Bart Becht and Olivier Goudet announced a $5 billion cash deal for the coffee unit of Mondelez International Inc. It was one of the rapid-fire purchases in JAB's $17 billion caffeine-infused race to create the world's second-biggest coffee conglomerate, behind Nestle and its 22 percent market share.

JAB began its coffee run in June 2012. It bought a 12 percent stake in D.E Master Blenders 1753 NV, the maker of Senseo and Douwe Egberts brands. It increased that to 15 percent in October 2012 and bought the whole company in October 2013. At $10.4 billion, the deal was the biggest ever in the $84.5 billion market for ground and instant coffee and coffee beans. This year, JAB plans to combine the Mondelez business, the second-largest coffee maker, with an 11 percent market share, and No. 3 Master Blenders, at 5 percent, into a new company called Jacobs Douwe Egberts. JAB will also run three coffee shop and bagel chains, including Peet's Coffee & Tea Inc. and Caribou Coffee Inc., in the U.S.

If anyone can figure out how to profit from the world's growing thirst for coffee, JAB can, says Ali Dibadj, who covers consumer products at Sanford C. Bernstein & Co. in New York. Trott's BDT Capital brought in co-investors, including Colombian billionaire Alejandro Santo Domingo. Harf tapped two of the founding families of Anheuser-Busch InBev NV, the world's largest brewer. Becht, who serves as JAB's chairman, says the firm's executives, junior partners and handpicked chief executive officers for the companies it controls have their own money riding on success. "We've all invested pretty much close to our total personal wealth in JAB," he says during a November interview.

JAB managed about $28 billion in assets in 2014, double the $14 billion in 2011, Becht says. JAB's equity value rose to $15.2 billion at the end of 2014 from $9 billion at the end of 2011. "The JAB guys are the best team in consumer goods. Period," Dibadj says. "These folks are the smartest operators of companies that I've ever seen."

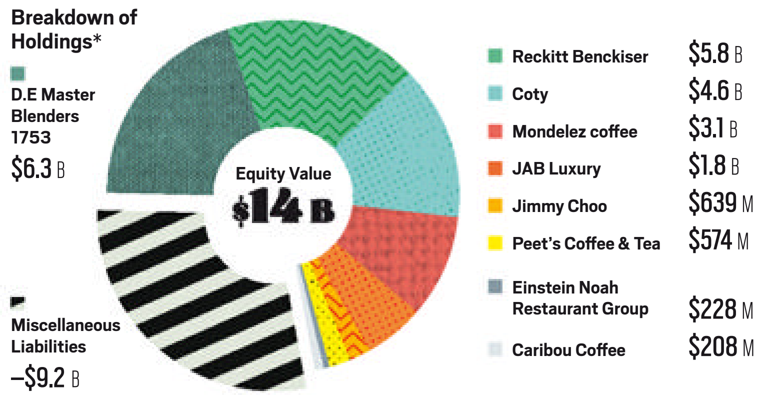
The JAB trio may be savvy dealmakers and managers, but they're little known outside of Europe. Harf, who was born in Germany, led JAB for almost a quarter century before bringing in two partners. Dutchman Becht, 58, ran decongestant and condom maker Reckitt Benckiser Group Plc in Slough, England, before joining in 2011. Goudet, 50, a Frenchman, was chief financial officer of candymaker Mars Inc.

The four billionaire Reimann siblings who entrust JAB with their fortunes are even less visible. Four years after the death of Albert Reimann, the great-great-grandson of the original co-owner of chemical maker Joh. A. Benckiser GmbH, his nine adopted heirs appointed Harf as CEO to manage their assets. Albert Reimann had left each with 11.1 percent stakes in the family chemical company. In 1996, five Reimanns bought out their four siblings. Andrea Reimann-Ciardelli went on to sell her share for almost $1 billion in 2003 to the other siblings who'd kept their stakes. These Reimanns, all trained scientists, have never been involved in any JAB businesses and have never granted interviews. The family declined to comment for this story.

Under Harf's tutelage, the Reimanns have moved into the ranks of the world's 500 richest people. Renate Reimann-Haas, 63; Wolfgang Reimann, 62; Stefan

Coffee, Coty, Choo

JAB invests the Reimann family's $14 billion fortune in household staples and luxury brands.



**Represents the combined holdings of Matthias Reimann-Andersen, Stefan Reimann-Andersen, Wolfgang Reimann and Renate Reimann-Haas as of Jan. 22. Source: Bloomberg*

PREVIOUS SPREAD: ANGELA CAMPOS/STOCKLAND MARTEL

Senior partner **Peter Harf**, below, has orchestrated JAB's consumer-products push. CEO **Olivier Goudet**, right, arrived in 2012, a year after Chairman **Bart Becht**, far right.

CLOCKWISE: DYLAN COULTER; HANS-RUDOLF SCHULZ; GILBERTO TADDAY

Reimann-Andersen, 51; and Matthias Reimann-Andersen, 49, have individual net worths of $3.5 billion, according to the Bloomberg Billionaires Index. They control 92.5 percent of JAB's equity, with JAB executives owning the rest. "Peter is a great patriarch and *consigliere* to the family," says Trott, who met Harf through Goudet. "He's been with the Reimanns from the very beginning. Their trust and confidence in JAB stems from that relationship."

With its shift into coffee, JAB is backing a consumer favorite with unique staying power. Grocery items from soda to soup have seen sales dented by price wars and health concerns. The coffee market has grown by 44 percent since 2009 and is expanding at about 5 percent a year, according to Euromonitor International. Single-serve capsules, delivered by machines such as Nestle's Nespresso, are rising at quadruple that rate. Where JAB's plans may falter is in its lack of innovation with roast and ground coffees. JAB's Peet's and Caribou shops will be butting up against outlets run by giants Starbucks Corp. and Dunkin' Brands Group Inc. "They're No. 2, but a distant No. 2 at the moment," says Jonny Forsyth, a beverage industry analyst at Mintel Group Ltd.

JAB also faces a looming deadline that could derail its ambitions. It's awaiting a decision by European Union regulators, due by May 6, on whether combining Mondelez's coffee business with Master Blenders will hurt competition. To appease regulators, JAB has put the L'Or Espresso and Cafe Grand'Mere brands on the block.

What JAB lacks in coffee experience, it might make up for with its speed and willingness to spend. Dave Burwick, who at the time was North American head of Weight Watchers International Inc., says he was ready to accept an offer to become CEO of publicly traded Peet's Coffee in the summer of 2012. Then its board suddenly went silent. The next thing he knew, JAB had swooped in to buy Peet's. Burwick found himself once again interviewing for the CEO job, this time over breakfast at the Sofitel New York hotel with Harf, Becht and Goudet. They offered him the post the next day. "I went from probably being CEO of a public company to being CEO of a private company, working for guys I had not even met 24 hours before," Burwick recalls.

Becht says he's always had a passion for coffee. "I've been investing in coffee for a long time, ever since Green Mountain Coffee became public in 1993," says Becht, who has since sold his shares in the company now called Keurig Green Mountain Inc. Harf met Goudet, who's now JAB's CEO, on the board of another beverage company,

beermaker Anheuser-Busch InBev. Goudet, a silver-haired expatriate who lives outside Washington, was also bullish on the drink. "He developed our coffee strategy," Harf says in an e-mail. "We like the growth, the low capital intensity, the stability over the business cycle and the pricing power of strong brands."

Harf arrived at Joh. A. Benckiser GmbH in 1981, fresh from Boston Consulting Group. The namesake company was founded by Johann Adam Benckiser in 1823 in Pforzheim, Germany, and attracted chemist Ludwig Reimann five years later. The company passed to the Reimann family when one of Johann Benckiser's heirs ceded his stake. It went on to spend a century and a half making citric acid and other specialty chemicals before wading into such products as denture adhesive cream. Harf embarked on an international buying binge, adding European detergent makers, and began selling the chemical assets. The consumer business accelerated with Becht, who joined Benckiser from Procter & Gamble Co. in 1988. Four years later, Harf acquired perfume maker Coty from Pfizer Inc. for about $440 million. "We bought consumer-goods businesses from companies for which it wasn't the primary interest," Becht recalls. "You could make a lot of changes and have a big impact."

1823
Joh. A. Benckiser founded

9
Children adopted by Albert Reimann*

4
Reimann siblings with 23% JAB stakes

$3.5B
Net worth of each JAB-owning sibling

*Great-great-grandson of original co-owner. Figures as of Jan. 22.
Sources: Bloomberg, JAB

Becht and Harf worked in tandem. Becht rose to CEO of household-products maker Benckiser NV in 1995, while Harf engineered a merger with British consumer-goods outfit Reckitt & Colman Ltd. to create Reckitt Benckiser in 1999. Becht posted annual net income growth of more than 10 percent during most of the next decade. Market value increased more than sixfold, earning Becht $137 million from share options in 2009. "Peter trained Bart," Trott says. "He was his protégé, very well skilled and schooled."

Seeking a favorable tax environment for the Reimanns, Harf moved their family offices, Lucresca SE and Agnaten SE, to Vienna from Ludwigshafen, Germany, in 2006. The family traded their German passports for Austrian ones. Harf created high-end retailer Labelux Group GmbH the next year, adding fashion brands Bally, Belstaff and Zagliani. Labelux purchased Jimmy Choo from private-equity firm TowerBrook Capital Partners LP in May 2011.

Luxury products haven't lived up to JAB's expectations. Coty pulled a $10.7 billion bid for cosmetics seller Avon Products Inc. in May 2012. Then it delayed its own IPO. When CEO Michele Scannavini left, Becht came in to run the business for now. In October, JAB took Jimmy Choo Plc public in London. The shoemaker's 650 million pound ($976 million) market value on Jan. 20 was only 100 million pounds more than JAB had paid in 2011. JAB folded Labelux last year and put the brands under its direct control. "We don't claim that we're experts in luxury," says Becht, a fan of Coty's Bottega Veneta fragrance, who's wearing a black Armani Collezioni suit and a white shirt without a tie in Coty's New York office. "Having said that, the businesses are gradually doing better and better."

Coffee is showing more promise, especially when it's combined with bagels. On Sept. 4, Goudet approached billionaire investor David Einhorn about bagel chain Einstein Noah Restaurant Group Inc., according to a person familiar with the talks. Einhorn's hedge fund, Greenlight Capital, was Einstein's largest stockholder, with more than a 35 percent stake. The two met at Cafe Centro in New York's MetLife building. Harf and Becht didn't take part in the discussions. Goudet was easy to deal with, the person familiar with the matter says. The acquisition, valued at $374 million, was announced on Sept. 29 and closed five weeks later. "We do the standard market scouting of what's out there, try to build relationships over time with targets and see if we can make transactions happen," Becht says. "The guns-blazing approach generally doesn't work. We've never done hostile transactions and aren't planning for one."

All the same, JAB isn't ruling out potential coffee deals, including Keurig Green Mountain. "Time will tell if Green Mountain will ever be part of the portfolio," Becht says in November. "Nothing is excluded, ever."

Harf is betting on an experienced team, well-known investors and the trust of a billionaire family. "We know that it takes time to build successful companies," he says. "Our investment horizon is defined in generations, not years."

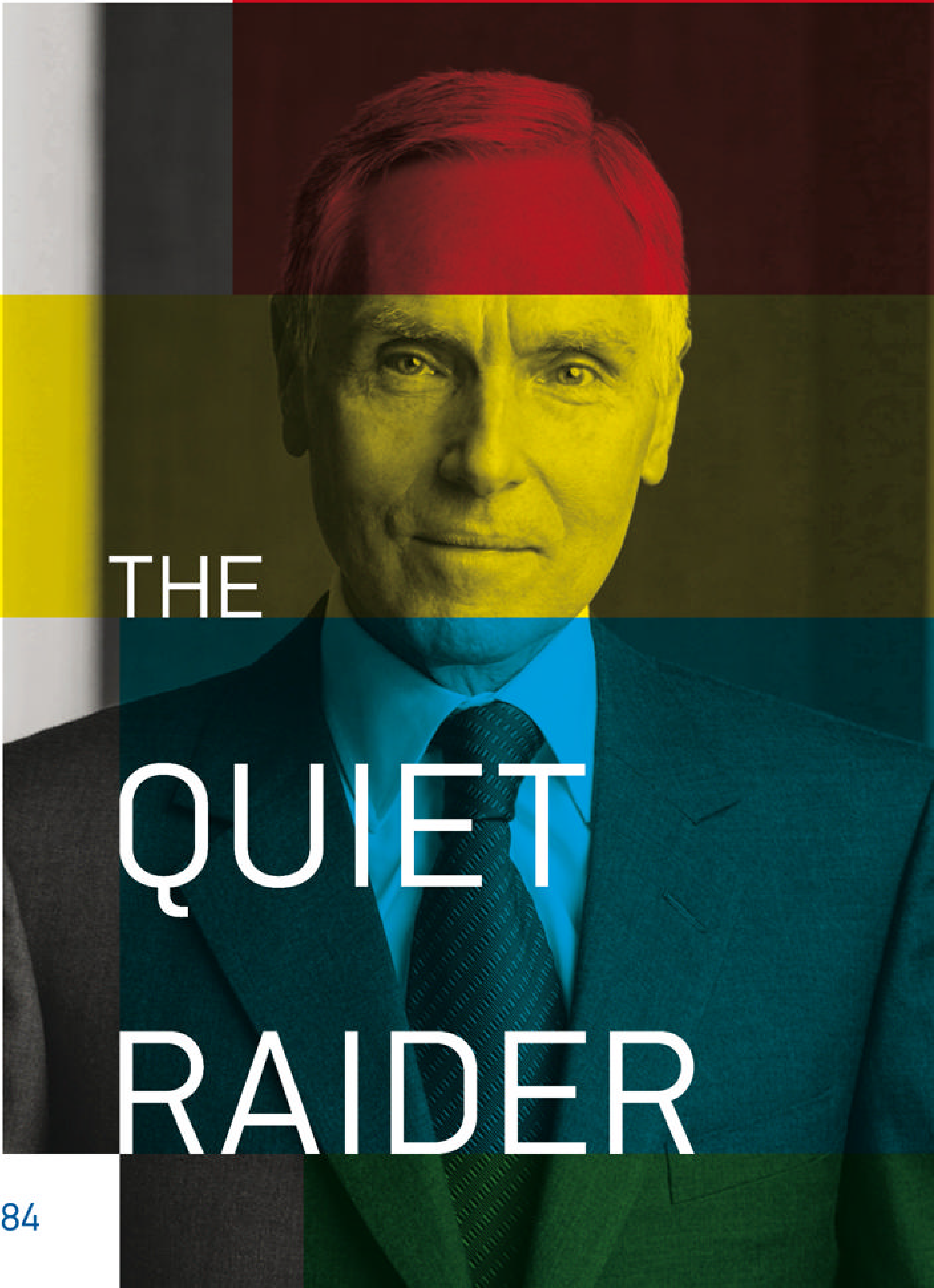
David de Jong covers billionaires at Bloomberg News in New York. ddejong3@bloomberg.net **Matthew Boyle** covers European consumer products in London. mboyle20@bloomberg.net

BLOOMBERG TIPS

What's Brewing in Coffee

For an overview of the retail coffee market, type **BI BEVG <Go>** for the Bloomberg Intelligence dashboard for beverages. To view market share data by company, click on Market Share under Data Library on the left side of the screen. Click on the Company Share tab and then on the Global subtab if it's not already selected. Scroll down to Hot Drinks By Retail Value and click on the plus sign to the left of Coffee to expand the list. Coffee was the best-performing futures contract in the 12 months ended on Jan. 12. You can use the Crop Calendar (CCAL) function to analyze supply. Type **CCAL <Go>**, click on the arrow in the upper-left corner of the screen and select Green Coffee. JON ASMUNDSSON

THE QUIET RAIDER



NEW YORK ACTIVIST INVESTOR EDWARD BRAMSON IS SHAKING UP LONDON'S MONEY MANAGERS, ONE CAMPAIGN AT A TIME.

BY JEREMY KAHN AND KIEL PORTER

THE CROWD ASSEMBLED beneath the ornate chandeliers in Saddlers' Hall in London is expecting a showdown. Sherborne Investors, led by Edward Bramson, a publicity-shy New York activist who has targeted a succession of British money management firms in the past four years, has called this shareholder meeting to oust one member of the board of Electra Private Equity Plc and add Bramson and another candidate as directors.

The management of Electra, one of the U.K.'s oldest private-equity firms, sits up front. Sherborne, having built a 20 percent stake in Electra at the time of this October gathering, has argued in a letter to shareholders that the firm's leadership is mismanaging its investments, overcharging investors on fees and interest, and underutilizing its cash.

Roger Yates, Electra's chairman, begins by explaining the board's opposition to Bramson's proposal and then asks for comments from the floor. Heads snap toward Bramson, a slight, pale 63-year-old with a full head of neatly combed silver hair, sitting with his team in the back rows. The seconds tick by, but Bramson stays silent, staring straight ahead impassively.

One shareholder stands and says he has met Bramson and come away unimpressed. Another complains about the cost of this proxy fight. The next speaker says Sherborne, if it sees so much value to be unlocked in Electra, should try to buy the company outright.

This is the most persistent criticism Sherborne has faced while pursuing a half dozen U.K. companies in a little over a decade: that a minority stake hardly justifies the management control it demands. Bramson has an answer to the critique—but doesn't offer it at the meeting. The shareholders vote, and Bramson loses, with 61 percent against his proposal. He walks out without having uttered a word.

The defeat for Bramson is rare, though his keeping quiet is not. He tends to let his results speak for themselves. Investors in Sherborne's funds and partnerships gained an average of 19 percent annually after fees for the 12 years through 2014, according to the firm. That's testament to a quirky, one-target-at-a-time activism that Bramson has arrived at after almost 40 years in the investment business. His returns put him up with the most successful activist managers, such as Bill Ackman, whose Pershing Square has returned 21 percent a year since it was founded in 2003, or Jeffrey Ubben, who can boast an average gain of 17 percent a year since 2000 at ValueAct Capital Management.

The London press has discovered Bramson, especially since 2010, when he went after F&C Asset Management Plc, an institution with a history that stretches back to 1868. Newspapers refer to him as an American corporate raider and complain he is "laying siege" to venerable U.K. firms and "parking his tanks on the lawn." A columnist for the *Evening Standard*, Nick Goodway, decries Bramson's activism as a bid for "creeping control" of a company and writes that it mostly benefits "the creeps."

The complaint at the shareholder meeting that Sherborne should buy Electra and pay shareholders a premium to do so came from none other than Edward Bonham Carter, a member of one of Britain's most established Establishment families. "If Mr. Bramson thinks there is 1 billion pounds of hidden value, he should make a bid for the company," said Bonham Carter, who's vice chairman of Jupiter Fund Management Plc.

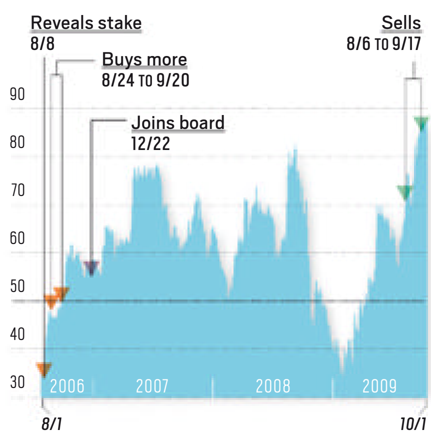
Bramson's response, delivered in a rare interview a month after the meeting, is that he doesn't owe shareholders a

PREVIOUS SPREAD: COURTESY OF SHERBORNE INVESTORS

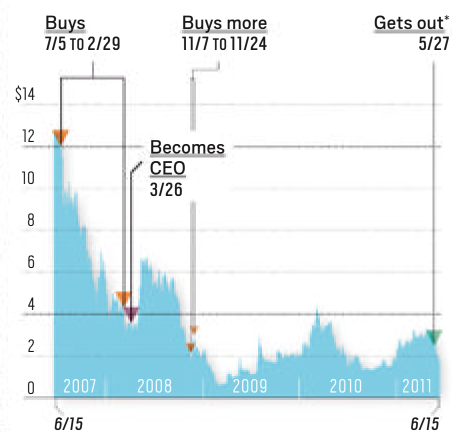
BRAMSON'S TRACK RECORD

Sherborne Investors has scored big wins with a string of activist investments in U.K. companies in the past decade—and suffered a setback at Nautilus, the one U.S. company it tried to turn around.

Spirent Communications (in pence)



Nautilus



**Sherborne distributes shares to its investors.*
Sources: Company filings, Bloomberg

Bramson has kept his firm small, making investment decisions with **Stephen Welker**, whom he hired as someone to mentor.

COURTESY OF SHERBORNE INVESTORS

premium because he isn't in control. Even with a board position—even as chairman—everything he does at a target firm requires the consent of directors who are not affiliated with Sherborne.

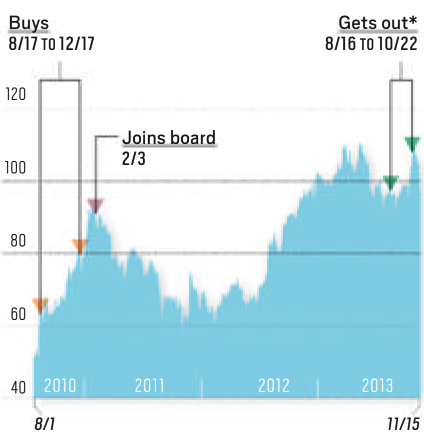
When Bramson invests, he outlines what he thinks is wrong with a target company in a letter to shareholders but doesn't berate management in public. In this, he's the polar opposite of an Ackman or a Carl Icahn. He has never run an hourslong press conference or opined about a target company on television. He only agreed to talk for this story after his outside public relations counsel convinced him that his reluctance to speak to the press was allowing others to cast him in a negative light.

At the interview, in his 32nd-floor, midtown Manhattan offices, Bramson discusses his investments and his methods at length, though he is reluctant to go into his personal life. With a commanding view of the Chrysler Building and the East River as a backdrop, he says he's been called a lot of names over the years: "corporate raider," "vulture investor," even "pond scum." The last is a joke, an example of Bramson's vermouth-dry sense of humor.

Bramson says what matters most to him is the opinion of his investors, who have included Soros Fund Management, BlackRock Inc. and Aviva Plc, the London-based insurer. "All those people know what we do. It is not a secret. They are the largest investing institutions in the U.K. or in the world. They don't think it's anathema."

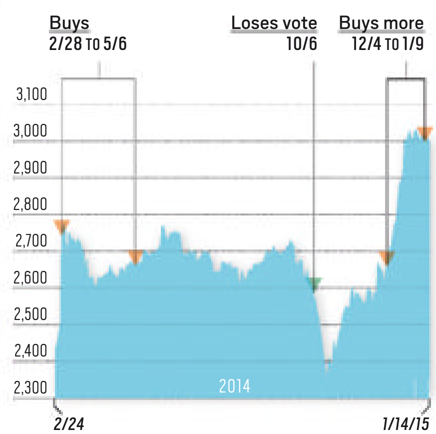
When Bramson invests, he likes to push for changes from within. He seeks at least one seat on the board, preferably as chairman. Once he has that, he says, he will spend a month or two meeting staff, asking questions and listening. Staying quiet is tactically smart in a turnaround, Bramson says. If you spell out your intentions early, you might stir resistance among the employees whose support you need later. "People usually won't defy you openly, because it's not a good career move," he says. "They stand back and watch you go over the cliff."

F&C Asset Management (in pence)



3i Group (in pence)

Electra Private Equity (in pence)



Each target gets Bramson's full attention, since he puts Sherborne's money into one company at a time. "If you want to diversify, do it yourself," he says.

Though the British press habitually describes Bramson as a U.S. raider, he was in fact born in England. His mother was American, his father, British, and he remains a U.K. citizen. One can still catch traces of his birth country in the way he rounds the vowels in words like *half* and in his preference for tea over coffee.

When he left for the U.S. at age 24, in 1975, he didn't look back. He was fed up with the economic malaise in Britain—and the politics. This was before Margaret Thatcher's government. Labour was in power. "They were very dirigiste," Bramson says. "They were actually talking admiringly about the French model of central planning."

A year after arriving in New York, Bramson joined a boutique firm being set up by William Sword, a former Morgan Stanley investment banker. This was the era when buyout firms such as KKR & Co. got their start. In his first deal, Bramson spun out Buffalo Color Corp., a producer of synthetic indigo dye, from Allied Chemical Corp. The deal had a price tag of $35 million. By constructing a Jenga tower of debt and preferred stock, Bramson managed to reduce the equity required to just $140,000, which was borrowed from one of Sword's backers, heirs to International Business Machines Corp. founder Thomas Watson's fortune. Bramson laughs and says that deal made him a pioneer in the use of excessive leverage, which became synonymous with the buyouts of that time. Bramson did another half dozen successful deals in the next decade before founding Sherborne. Then he promptly got in trouble.

In 1987, Sherborne acquired Ampex Corp., once a pioneer in audio and video tape recording equipment. It was a $479 million leveraged buyout for which Bramson put in about $60 million, financing the rest with junk bonds that carried a 13.25 percent interest rate. In Bramson's telling, everything went well for two years, and then it didn't.

Bramson was still trying to fix Ampex 20 years later, in 2007, when—in an ironic twist—an activist firm ousted him. Ampex filed for Chapter 11 bankruptcy protection 15 months later.

While Bramson says he lost his $60 million and spent decades trying to pay off bondholders and the company's underfunded pension, others have a different take. Doug Rowan, a senior vice president at Ampex from 1988 to 1990, says that when the junk bond market imploded around then, Bramson snapped up Ampex debt. That means some of Ampex's hefty interest payments were going to Bramson.

"We did buy some of their outstanding bonds," Bramson says. That helped but didn't entirely offset the losses on the equity, he says.

A whiff of *The Bonfire of the Vanities* still clings to Bramson. He admits going through "a toy phase." "I did like the houses, all that crap," he says. He owns horses. His wife is a dressage competitor, and she convinced him to learn to ride. "I like feeding them biscuits," he says. He also collects classic cars. Mirroring his investment style, it's restoring them, not owning them, that he enjoys most. "You get to see how they're really made. You admire the craftsmanship," he says. "At the end of it, though, all you've got is this old car—so I would typically sell them off."

In the early 2000s, Bramson almost shut down Sherborne. He was unhappy, he says, that private equity had become more about generating asset management fees than finding investment returns. That's when he hit on a new approach. He realized that he made more money improving businesses that were doing OK than trying to save companies that were in trouble. "The problem with the doggy ones is that they might actually be dogs," he says.

So Bramson morphed from private-equity investor to activist fund manager. He found a new partner in Matthew Peacock, a British banker who was setting up a boutique firm.

Bramson agreed to help fund Peacock's London-based Hanover Investors and run its U.S. office. Hanover helped Sherborne find deals. Together, Bramson and Hanover made 275 percent from the summer of 2003 to June 2004 with 4imprint Group Plc, a company that produces marketing and promotional materials. The next investment, in specialty chemicals company Elementis Plc, garnered a return of about 200 percent.

Despite their success, Peacock and Bramson parted ways. Peacock wanted to build a fund. Bramson, disdainful of funds, wanted to keep doing one investment at a time. Peacock declined to comment for this story.

'IF MR. BRAMSON THINKS THERE IS 1 BILLION POUNDS OF HIDDEN VALUE, HE SHOULD MAKE A BID FOR THE COMPANY,' SAYS EDWARD BONHAM CARTER.

BLOOMBERG TIPS

Following PE Deals

Type **SIGB LN <Equity> GP <Go>** to chart shares of Sherborne Investors (Guernsey) B Ltd. Listed in 2012, Edward Bramson's second publicly traded vehicle has paid irregular dividends from profits on Sherborne's investments. Type **DVD <Go>** to use the Dividend/Split Summary function to track its payouts. For a list of companies that Electra Private Equity has invested in, type **ELTA LN <Equity> MADL <Go>** for the Merger & Acquisition Deal List function. Click on the April 28 deal in which Electra led a group acquiring Innovia Group, for example. On the M&A Transaction Details screen, click on Deal Comps to compare the acquisition's multiples with those of similar transactions. JON ASMUNDSSON

Electra Chairman **Roger Yates** has so far fended off Bramson's bid for a role at his private-equity firm.

Beginning in August 2006, Sherborne built a 14 percent stake in Spirent Communications Plc, a telecom equipment company in Crawley, England, when the shares went for 34 to 44 pence. Bramson was elected chairman in December. By the time he sold the stake in August and September 2009, Spirent's shares were between 75 and 86 pence.

Not all of Sherborne's investments have worked out. Sherborne took a stake in Nautilus Inc., the Vancouver, Washington, maker of exercise equipment, in 2007 and lost 67 percent before getting out. The investment straddled the financial crisis, which cut off the consumer credit that Nautilus needed for a portion of its sales. The deal, along with Ampex, continues to haunt Sherborne, providing ammunition target companies use against it.

Bramson has kept his firm small and focused. When picking investments, it's basically a two-person show: Bramson and Stephen Welker, who joined the firm in 2007. Welker had spent a year, after graduating from Washington and Lee University in Virginia, as an investment-banking analyst at Morgan Stanley. Bramson was looking for someone to mentor. The two are a well-matched pair, often completing each other's sentences.

About two-thirds of Bramson's funds come from a publicly traded vehicle listed on London's Alternative Investment Market. In 2010, after Spirent, Bramson saw a need for permanent capital. Since investors, post-financial crisis, were demanding liquidity, he created a traded entity. Investors can buy or sell at any time, in theory, though the shares trade infrequently. Bramson avoids the risk of sudden redemptions. The first vehicle, offered in 2010, has been wound down; Bramson raised 200 million pounds ($300 million) with a second vehicle, Sherborne Investors (Guernsey) B, in 2012.

In total, Sherborne has about $500 million between the public vehicle and private partnerships, an amount that dictates the size of Bramson's target companies. Unlike most activists, he rarely uses leverage, saying he learned his lesson in prior decades. With concentrated bets, done one at a time, Bramson has to aim for huge returns on every campaign. He tells investors he seeks to at least double their money on each target.

'PEOPLE USUALLY WON'T DEFY YOU OPENLY, BECAUSE IT'S NOT A GOOD CAREER MOVE,' BRAMSON SAYS. 'THEY STAND BACK AND WATCH YOU GO OVER THE CLIFF.'

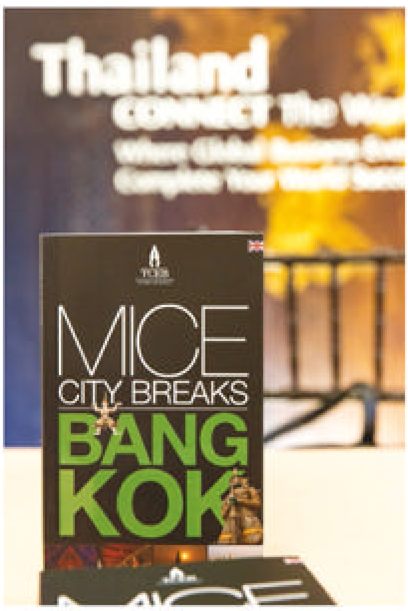
Bramson and Sherborne Investors clearly have made a stir in the City. After the Spirent win and the Nautilus setback came F&C, where Bramson ultimately became chairman and made a return of about 70 percent. Then Sherborne flirted in 2013 with 3i Group Plc, another private-equity shop. Sherborne bought a 5 percent stake that January and sold it the following November for about a 38 percent gain, having never contacted management or agitated for changes. That confused people, but Welker explains: 3i stock got too expensive to allow for the gains of 100 percent or more Sherborne seeks, so they got out.

Bramson was surprised to have lost the Electra proxy battle. "Frankly, we thought we were ahead," he says. But he adds that Electra is making some changes he advocated—announcing, immediately after the October meeting, a strategic review of its fee structure, for example. "So we'll see how it goes," he says.

In fact, Sherborne in December and again in January upped its Electra stake, reaching 23 percent, worth about £250 million. The shares gained 24 percent from February 2014, just before Sherborne first bought, through early January. A nice profit, but Bramson aims for much more. Once again, the quiet activist has London waiting on his next move.

Jeremy Kahn is a senior writer at *Bloomberg Markets* in London. jkahn21@bloomberg.net **Kiel Porter** covers private-equity firms at Bloomberg News in London. kporter17@bloomberg.net

Media giant Bloomberg selected Bangkok as the ideal destination for its first ASEAN Business Summit, held at the Postal Heritage Hall in the 80-year-old Grand Postal Building next to the Chao Phraya River from 2-3 December 2014.



In making Bangkok the chosen venue, Parry Ravindranathan, Managing Director, Bloomberg Media, Asia Pacific explained: "Thailand is a key player in the ASEAN community and an important market for our business, hence we wanted to demonstrate our commitment to this growing economy." The unique Grand Postal Building proved an ideal setting for an activity-packed one and a half days, during which Bloomberg's best known correspondents interviewed prominent business and political figures from across Southeast Asia - both individually and in panel format - about the challenges and opportunities within ASEAN. Audience interaction and questions were facilitated through the use of Pigeonhole Live throughout the two days.

Thailand Convention and Exhibition Bureau (TCEB), the lead government agency promoting business events in Thailand and one of the event's key sponsors, hosted an invitation-only breakfast on December 3 to focus attention on Thailand's future role within ASEAN.

Over 400 top CEO delegates from 16 countries plus Thailand attended the summit, primarily influential leaders and senior executives from the global business, finance and government sectors. Their purpose was to exchange information and discuss a variety of essential topics about the region's economic development as it prepares to launch the ASEAN Economic Community at the end of 2015.

In bringing this important regional event to Bangkok, TCEB highlighted the success of its "Thailand CONNECT" global marketing campaign. TCEB is tasked with developing and growing the country's meetings, incentives, conventions and exhibitions (MICE) sector.

The Thailand CONNECT campaign is designed to facilitate and encourage meeting organisers to bring their events to Thailand as a premier MICE destination. It does so by focusing on three pillars: diversity of Thai destinations, particularly its five 'MICE Cities'; the high quality of Thailand's MICE professionals; and unrivalled business opportunities.

As ASEAN's second largest economy, Thailand is ready to play a leading role in the forthcoming ASEAN Economic Community (AEC) and its combined population of around

Major Business Events

Choose to Connect with Thailand

600 million. Economic integration will remove trade barriers between the 10 ASEAN countries, resulting in the free transfer of goods, services, skilled labour, trade and investment. Thailand itself is a production and export base for many key industries: automotive, computer parts, IT, energy, rubber and plastics.

While the summit focused its attention on various important aspects of ASEAN, such as energy, financial services, infrastructure, monetary policy, and what the future holds, TCEB's private breakfast session focused attention on Thailand's key role and potential within ASEAN. It did so by inviting Dr. Supachai Panitchpakdi, former Secretary General of the UN Conference on Trade and Development and former Thai Deputy Prime Minister, to give his views on Thailand through a one-on-one interview by William Pesek before 50 invited business leaders assembled in the Postal Theatre.

While acknowledging political instability in Thailand, Dr. Supachai noted that the new government had brought peace and social stability to the country. He was full of praise for Thailand's macroeconomics, which he called superb, probably the best in Southeast Asia, with many indices upgraded. In fact, Thailand has moved up to 31 out of 144 countries in the World Economic Forum's Global Competitiveness Rankings for 2014-15.

Dr. Supachai believes the Thai government has many great plans to benefit the country, and urged it to forge ahead with road and rail links to China, as well as India via Myanmar. "If we make these physical connections, Thailand and ASEAN will grow," he said.

After many intensive sessions and much networking, the summit ended with a celebratory lunch in the Grand Postal Building. Bloomberg is so pleased with the "overwhelmingly positive

feedback", that it is now considering future summits to place closer global attention on ASEAN's economic and business potential.

TCEB is also pleased with the positive outcome of the summit. According to TCEB President, Mr. Nopparat Maythaveekulchai, a core part of TCEB's mission is to support forums such as the Bloomberg summit. "TCEB passionately believes that the MICE industry can operate as a catalyst to boost all sectors, and that Thailand is uniquely positioned to unlock the potential of the AEC for those who choose the Land of Smiles as host for their business event."

TCEB believes that the outstanding success of the summit and its Thailand CONNECT campaign will encourage other international event organisers to consider Thailand as an attractive destination for their events with high potential for success.

Thailand CONNECT TCEB

www.businesseventsthailand.com

STRATEGIES

PROFILE

Tax-Efficient Investing

Ballentine Partners, which oversees $5 billion for 154 wealthy families, focuses on maximizing returns and minimizing the share the government takes.

BY JON ASMUNDSSON

BALLENTINE PARTNERS IS a wealth management firm with roots in an unusual institution: a summer camp.

Camp Kehonka, founded in 1902, brought girls to the southeast shore of Lake Winnipesaukee in New Hampshire to swim and make handicrafts. In 1910, a young man named A.C. Ballentine applied for a job there. No position was open, but the camp's founder invited him to visit for a week. Ballentine ended up staying for the rest of his life, becoming owner and director of the camp. "He went as a guest and he never left," his son Roy Ballentine says.

By the time the elder Ballentine died in 1984, the camp's mile of waterfront land on New Hampshire's largest lake had become very valuable. So, largely to pay the tax bill, the family sold it. "The sale of the camp was a very traumatic event within my family," Ballentine, 65, says. "There were people who literally stopped talking to me for over a decade because I was right in the center of all the decisions we needed to make."

In trying to hang onto the camp, the family used capable advisers on taxes and trusts, Ballentine says. Yet the advisers tended to narrowly focus on their areas of specialty and were stumped by questions about strategy.

Ballentine, who had been a computer salesman for International Business Machines Corp., says he was unable to find an investment advisory firm that could provide the broad, strategic counsel his family needed. So he decided to create one—the wealth manager that became Ballentine Partners.

THE MAIN IDEA of the firm, says Ballentine, who is chairman and CEO, is to harness financial planning to investing. Ballentine Partners, which is based in Waltham, Massachusetts, now oversees $5 billion for 154 families and individuals, with an average net worth of about $50 million.

Coventry Edwards-Pitt, the firm's chief wealth advisory officer, says that Ballentine serves only families with taxable income, not foundations or other institutions. "We care very much about taxes,"

COVENTRY EDWARDS-PITT, WILL BRAMAN

CHIEF WEALTH ADVISORY OFFICER, CHIEF INVESTMENT OFFICER, BALLENTINE PARTNERS

- Serve only **families and individuals**.
- Focus on **taxes**.
- Use **ETFs** for equity investments.

HAIR, MAKEUP AND GROOMING: CAITLIN MURPHY

Edwards-Pitt, left, and **Braman**, at the firm's Waltham, Massachusetts, office, say taxes govern their investing.

PHOTOGRAPH BY BEN HOFFMANN

she says. "It governs how we do everything."

As an example, Edwards-Pitt points to the market crash in 2008. Ballentine's clients invest in the U.S. equities market via exchange-traded funds. When the market was near its bottom, Ballentine had them sell those funds and buy into "like kind" ETFs, which they then rode back up. "We were able to capture all of those taxable losses for our clients," she says, referring to tax laws that allow investors to carry losses forward over multiple years.

'WE FOUND A $50 MILLION ESTATE-PLANNING MISTAKE,' EDWARDS-PITT SAYS.

Ballentine doesn't pool client assets, Edwards-Pitt, 38, says. Each family's investments are tailored to their needs, she says. (One consequence is that Ballentine isn't allowed to report investment results except in one-on-one meetings, she says.)

Chief Investment Officer Will Braman says the firm's investing approach is based on four building blocks: equities, fixed income, real assets and alternatives. The firm employs 24 financial planners that help each family set allocations to those areas based on their need for income, liquidity and willingness to take risks.

One family, for example, may allocate 50 percent to equities, with a maximum of 60 percent and a minimum of 40 percent, Braman says. What's in that allocation will look similar for different clients. "By and large, in public equities, we're using ETFs, because they are the lowest cost," he says. "And they are the most tax efficient."

Making the case for ETFs, Braman points to data from S&P Dow Jones Indices, which showed that, as of mid-2014, 87 percent of U.S. large-cap active managers trailed the Standard & Poor's 500 Index for five years after fees. After taxes, he says, almost none of the active managers beat the U.S. benchmark.

Within the bond allocation, Braman says, the largest slice is municipal bonds, thanks to their tax advantages. For real assets, most Ballentine clients have about 6 percent in master limited partnerships, 4 percent in real estate investment trusts and 1 percent in commodities.

BRAMAN SAYS THAT Ballentine tends to make smaller allocations to alternatives than many wealth management shops. The reason: Private pools aren't tax efficient, he says. "Most of the gains come as short-term gains or income," he says.

Alternatives, though, are valuable for their low volatility and low correlation to the broader markets, he says. "Traditionally, we have been a fund-of-funds shop," Braman says. "We've used the Corbin Pinehurst fund for probably seven years," he says, referring to a fund-of-funds run by New York–based Corbin Capital Partners. Braman says the seven-year return on the fund was similar to that of the S&P 500, with about a third of the volatility.

TIP BOX

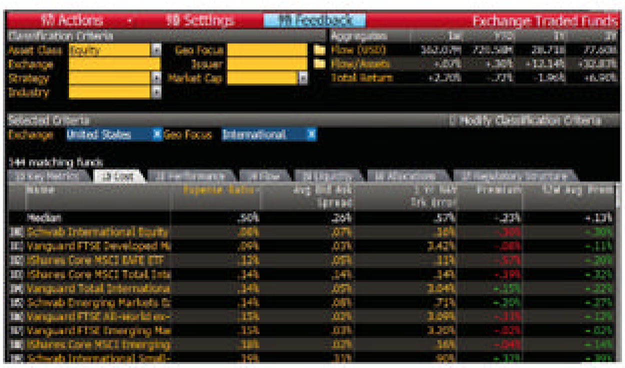
Type **ETF <Go>** to find funds that match your needs.

Edwards-Pitt, author of *Raised Healthy, Wealthy & Wise*, a book that aims to help well-to-do parents bring up grounded children, says the value generated in careful planning can sometimes dwarf investment performance. "We found a $50 million estate-planning mistake in a client who signed up with us," she says. "The holistic approach is necessary to get the best results."

Jon Asmundsson is Strategies editor of *Bloomberg Markets*.
jasmundsson@bloomberg.net

FINDING LOW-COST ETFS

Ballentine Partners uses ETFs to get inexpensive exposure to stock markets in the U.S. and overseas. You can use the new Exchange Traded Funds (ETF) function to compare ETF costs. To compare U.S.-traded ETFs that invest in international stocks, for example, type **ETF <Go>**. Click on the arrow to the right of Asset Class and select Equity if it's not already selected. Tab in to the EXCHANGE field, enter *UNITED STATES* and click on the matching item. Next, tab in to the GEO FOCUS field, enter *INTERNATIONAL* and select the match. Click on the Cost tab. To sort the list of ETFs by expense ratio, click on the column heading. JON ASMUNDSSON



How Liquid Is Your ETF?

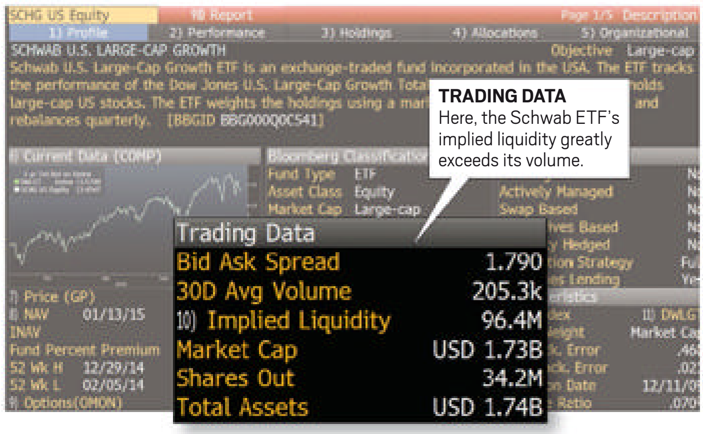
BY RYAN KREGER

THE WIDE-ANGLE view of the exchange-traded-funds market is one of explosive growth and variation. Last year, investors sank about $200 billion—more than the market value of Chevron Corp.—into U.S. ETFs covering a plethora of sectors, countries and strategies. Liquidity and transparency are the calling cards of the market, which has grown to some 1,600 funds managing combined assets of $2 trillion.

Look more closely and you see that ETFs differ widely in how successful they are at attracting money and how nimble they are in buying and selling positions. A new function on the Bloomberg Professional service lets you examine and compare the liquidity of these funds and their underlying assets.

IMPLIED LIQUIDITY IS a calculation of how many of an ETF's shares can be bought or sold without adversely affecting prices based on the trading volume of underlying securities. The measure is displayed in the Trading Data section of Description (DES) pages of ETFs on the Bloomberg service and is also available through Excel spreadsheets.

Now, it has its own dedicated analytic: the ETF Implied Liquidity (ETFL) function.



Type **DES <Go>** for a selected ETF. The Trading Data section of the screen shows its implied liquidity.

ETFL delves into the calculations that define implied liquidity. For a selected equity ETF, it identifies the security that's the least liquid in the portfolio. Another key feature is that the user can ascertain the implied liquidity value in both shares and a dollar-based notional value.

Before we go to the function, let's first take a look at the description of the Schwab U.S. Large-Cap Growth ETF. Type **SCHG US <Equity> DES <Go>**. Under Trading Data, you can see the average 30-day volume of the fund, which was a scant 205,300 shares as of Jan. 14. Multiply that by the share price of $50.71, and you have only $10.4 million in notional value traded on a given day.

Now, type **ETFL <Go>**. The implied liquidity was 99 million shares as of mid-January. That figure says to an investor that $5

Type **ETFL <Go>** to analyze a selected fund with the new ETF Implied Liquidity function.

TIP BOX

Type **BSKT <Go>** for info on the Fixed Income ETF Basket Tool.

billion in notional value can potentially be traded or created.

To a hedge fund or pension fund looking to make a large trade in the Schwab ETF, that reading indicates the fund can do so without making a substantial impact on the price of the underlying shares or getting trapped in an illiquid product. In this case, the investor could easily make a trade as large as \$50 million by enlisting an authorized participant to create new shares of SCHG by going out into the market and buying the underlying stock holdings of the fund.

CALCULATING IMPLIED LIQUIDITY

Determining the implied liquidity of an exchange-traded fund is based on calculating the implied daily tradable shares, or IDTS, for each stock that's included in the ETF's creation basket. The formula is:

IDTS = ((30-day ADV of the stock × VP) / stock shares per creation unit) × creation unit size,

where *ADV* is the average daily volume of the stock. *VP* is variable percentage, which is an adjustment that aims to limit any price impact on the stock by constraining the trade to a specified portion of average daily volume. By default, the VP is set at 25 percent.

This formula is based on calculations by David J. Abner that were published in *The ETF Handbook: How to Value and Trade Exchange Traded Funds* (Wiley, 2010). Abner is the head of capital markets at New York–based WisdomTree Asset Management. RYAN KREGER

The VARIABLE PERCENTAGE field in the upper-right corner of the page can be adjusted according to your confidence in the overall liquidity in the market or the basket of holdings.

The function also enables you to edit the creation basket. That means you can dig into the question of how removing illiquid assets and replacing them with cash or similar securities would affect liquidity.

FOR EXAMPLE, CLICK on Edit Basket in the bottom left of the screen. As of Dec. 14, the two stocks that had the lowest numbers of implied daily tradable shares, or IDTS, and hence constrained the liquidity of the ETF the most were Rollins Inc., the Atlanta-based owner of Orkin Exterminating, and Erie Indemnity Co., an Erie, Pennsylvania–based insurer.

To remove the two least-liquid stocks from the basket, click on the boxes to the left of their names to remove the check marks. Click on Save.

Removing the Rollins and Erie Indemnity stocks boosts the implied liquidity of the whole portfolio to 110.9 million shares worth a notional \$5.78 billion. This feature gives you a clearer understanding of what you're getting into when participating in the creation and redemption process.

ETFL and the implied liquidity data enable you to understand how an ETF's underlying assets impact trading of the overall fund. Armed with this knowledge, you can dramatically expand your choices of investable funds to include those that may have seemed off-limits before.

Ryan Kreger is on the staff of the Data Management department at Bloomberg in Princeton. rkreger2@bloomberg.net

ETFL lets you investigate how removing a stock might affect an ETF's implied liquidity.

Tracking ETFs

EXTF <Go>
lets you access exchange-traded fund-related information, functions and links.

ETFL <Go>
enables you to analyze the so-called implied liquidity of a selected equity ETF, based on trading in its underlying stocks.

AQR <Go>
displays the trades with the largest impact on a selected ETF.

BETA <Go>
graphs the historical sensitivity of a selected fund to a market benchmark.

BI ETFS <Go>
lets you access ETF-related research by Bloomberg Intelligence analysts.

COMP <Go>
graphs comparative returns.

PORT <Go>
lets you perform attribution analysis on a selected ETF and determine the sources of its performance.

CORR <Go>
lets you analyze correlations among as many as 500 securities.

FMAP <Go>
lets you map performance or other metrics for the ETFs in a fund family or other list.

FREP <Go>
lets you generate a comprehensive report for a selected ETF.

NAV <Go>
lets you chart a selected fund's premium or discount to net asset value and net flows.

FSCO <Go>
lets you create scoring models to rank a group of ETFs.

↑ **ETF <Go>**
enables you to find and compare ETFs that match criteria you specify.

WETF <Go>
monitors fixed-income ETFs.

OWN <Go>
shows the institutional and insider holders of a selected ETF.

FSRC <Go>
lets you screen for funds based on criteria you specify.

FL <Go>
lets you look up ETFs by name.

MHD <Go>
displays a selected ETF's holdings.

XLTP LEAG <Go>
ranks issuers by ETF fund flow.

QM <Go>
displays quotes from the multiple exchanges that an ETF trades on.

RANK <Go>
ranks brokers by advertised trade volume for a selected ETF.

TCA <Go>
lets you estimate the trade cost of various execution strategies for a selected ETF.

SI <Go>
displays short interest on a selected fund.

OMON <Go>
monitors options on a selected ETF.

HFA <Go>
charts the historical performance of a selected fund.

Compiled by
JON ASMUNDSSON
jasmundsson@bloomberg.net

PULL OUT AND SAVE. // **PRESS <HELP> TWICE** TO SEND A QUESTION TO THE BLOOMBERG ANALYTICS HELP DESK.

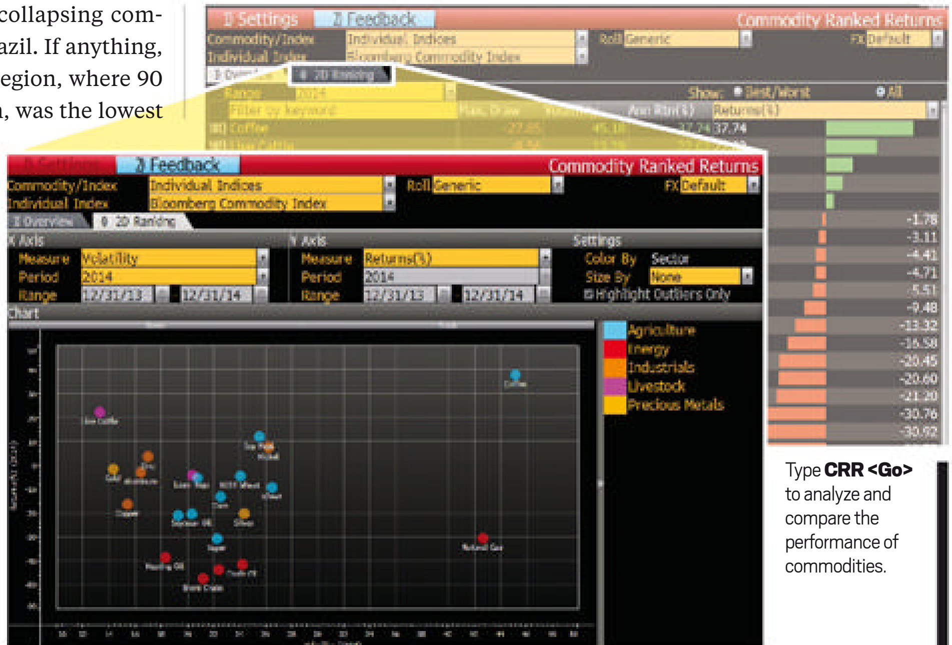
TEAR OUT AND SAVE

Smell the Coffee

BY DEBBIE MASSIELLO AND BETH HAUSMANN

ONE SUNNY SPOT in a year of collapsing commodities prices was southwest Brazil. If anything, it was too sunny. Rainfall in the region, where 90 percent of Brazil's coffee is grown, was the lowest in 80 years in early 2014.

Brazil is the world's largest producer of Arabica coffee, so the drought had a big impact on the crop. Brazil's National Coffee Council, known as CNC, said that the 2015 harvest could drop below 40 million 60-kilogram (132-pound) bags, the lowest since 2009. As a result of the short supply, coffee was the best-performing major commodity futures contract in 2014. The generic contract gained 50 percent for the year.



Type **CRR <Go>** to analyze and compare the performance of commodities.

To compare the performance of commodities, type **CRR <Go>** for the Commodity Ranked Returns function. CRR lets you rank the performance of various futures contracts based on returns, volatility or maximum drawdown. You can also use CRR to compare commodities indexes or to dig into the drivers of a particular benchmark's performance.

THE INVESTABLE Bloomberg Commodity Index tracks the 22 most-liquid futures contracts. In July 2014, Bloomberg took over the calculation and distribution of the Dow Jones-UBS Commodity Index, which was renamed the Bloomberg Commodity Index. The rebranded benchmark offers the same diversified exposure to global commodities.

To dig into what's driving the index's returns, click on the arrow to the right of Commodity/Index and select Individual Indices. Next, click on the arrow to the right of Individual Index and select Bloomberg Commodity Index.

CRR shows that, in 2014, coffee was the best-performing component of the benchmark. The worst performer was Brent crude, which declined 48 percent during the year.

For a scatter plot that lets you chart two metrics for the constituents of the index, click on the 2D Ranking tab. Plotting volatility on the X axis and returns on the Y axis, coffee stands out as both the best performer in 2014 and the highest-volatility commodity. Energy futures were clearly the worst performers. By plotting different periods, you can tease out trends as they unfold.

Debbie Massiello and Beth Hausmann are application specialists at Bloomberg in San Francisco. dmassiello@bloomberg.net, bhausmann@bloomberg.net

TIP BOX

Type **FDM <Go>** to find fundamental data related to commodities.

Looking for Clues in Saudi Riyal Forwards

BY CHRISTOPHER WEISS

SAUDI RIYAL CURRENCY forwards spiked after King Abdullah's death was announced on Jan. 23. The instruments can be an important barometer for monitoring stress in the kingdom—and in global oil markets generally. They may even provide clues about the direction of crude prices.

A chart of Saudi riyal forwards shows their volatility as oil prices collapsed.

The kingdom's currency, of course, is pegged to the dollar by the Saudi Arabian Monetary Agency at a rate of 3.75 riyals to the dollar. So the spot rate will typically convey only very limited information about market sentiment. The riyal forwards market, however, is liquid and driven by market forces.

IF THE FORWARDS move sharply higher, that's potentially a bearish signal for the price of oil. Looked at in light of the recent collapse in global crude prices, such moves in the forwards may indicate the market's lack of confidence in the Saudi-led strategy of favoring oil market share at the expense of prices.

As the world's largest net exporter of oil, Saudi Arabia has racked up a huge current-account surplus. You can use the International Reserve Assets (WIRA) function to track such data. Type **WIRA <Go>**. As of Jan. 12, Saudi Arabia had most recently reported holding $734 billion in reserves. That ranked third in the world, after China and Japan, and represented about 6 percent of the global total. Under normal market conditions, Saudi currency volatility is minimal. Riyal forwards usually trade close to or below the spot rate.

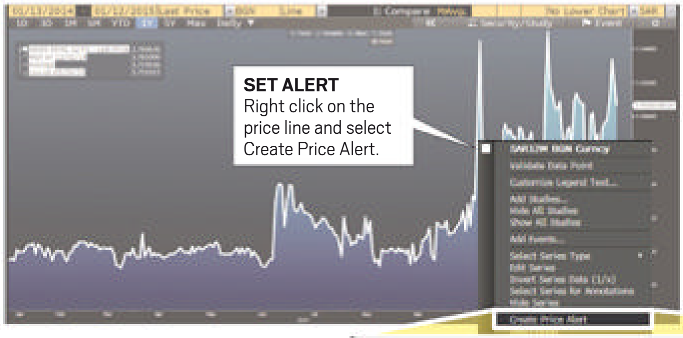
In effect, that situation suggests that the market expects the riyal to appreciate against the dollar in the future and that riyal-denominated interest rates implied by FX forwards will be at or below dollar interest rates.

Over the past several years—perhaps linked to the onset of the Arab Spring—the one-year riyal forward has traded above spot. (The one-year tenor is a good sentiment indicator. Its price movements tend to closely follow macro flows and events, whereas changes in shorter-tenor forwards are more sensitive to daily interbank operational funding issues.) This price trend implies an expectation of a weakening currency and of rising interest rates—both indications of a drop in confidence.

Part of the move higher in Saudi FX forwards may be explained by low U.S. dollar interest rates. Yet since October, riyal 12-month forwards have remained particularly elevated, reaching a five-year high of 109 pips above spot on Oct. 21. (Pips are the last two significant digits in foreign-exchange quotes.) Higher pips imply selling of the riyal

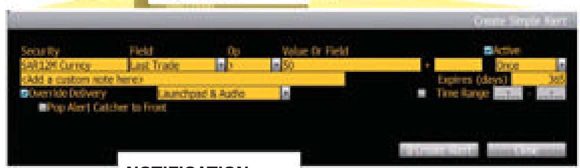
TIP BOX

Type **OTC SAR <Go>** to monitor Saudi market data.



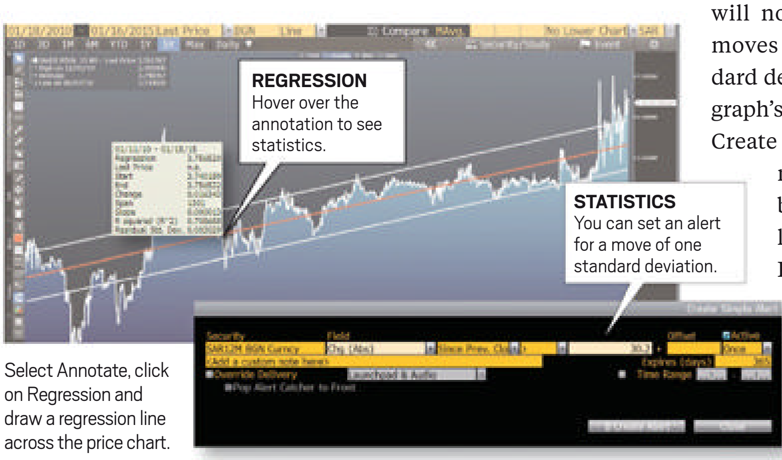
against the dollar, which may suggest downward pressure for the oil price. The higher level of forwards suggests net outflows from Saudi Arabia as the oil price fell below $80 a barrel and contagion caused a parallel drop in Saudi equity markets and investor confidence.

To keep an eye on the often-overlooked Saudi riyal currency market, you can set an alert that will notify you when one-year forwards trade above a certain level. First, let's take a look at a graph of the forwards. Type **SAR12M <Crncy> GP <Go>**. Move your cursor over the line in the graph and right click on it. In the pop-up menu that appears, click on Create Price Alert. The next step is to decide on a price level to trigger the alert.



Type **SAR12M <Crncy> GP <Go>** to graph 12-month Saudi riyal forwards.

TO SET AN ALERT that will notify you when the forwards trade above 50 SAR points, for example, click on the arrow below Field and select Last Trade if it isn't already selected. Next, select > Greater Than as the operator. Enter *50* in the VALUE OR FIELD field and press <Go>. You can also set the frequency with which you want to be notified by clicking on the arrow to the right of Once and making a selection. You can also specify how you want to be alerted. Click on the box to the left of Override De-



Select Annotate, click on Regression and draw a regression line across the price chart.

livery so that a check mark appears. Then click on the arrow to the right and make a selection. Finally, click on the Create Alert button.

You can also set an alert based on standard deviation, which is a statistical measure of how tightly observations cluster around their mean. To calculate the standard deviation of a price series shown in a graph, right click on the graph above or below the price line. In the pop-up menu that appears, select Annotate and click on Regression. Click first on one end of the span you want to analyze and then on the other end. Hover your cursor above the regression line that appears to display a window showing the associated residuals. For a five-year span, for example, the standard deviation, which is shown as Residual Std. Dev., was 30.2 as of Jan. 16.

You can use that number to create an alert that will notify you when the price moves by more than one standard deviation. Right click on the graph's price line again and select Create Price Alert in the pop-up menu. Click on the arrow below Field again and select Chg. Abs. Select Since Prev. Close if it isn't already selected. Select > Greater Than, enter *30.2* in the field to the right and press <Go>. Click on Create Alert.

Since the riyal isn't a free-floating currency, it's debatable whether it's better to base your alert on an absolute level or on a standard deviation.

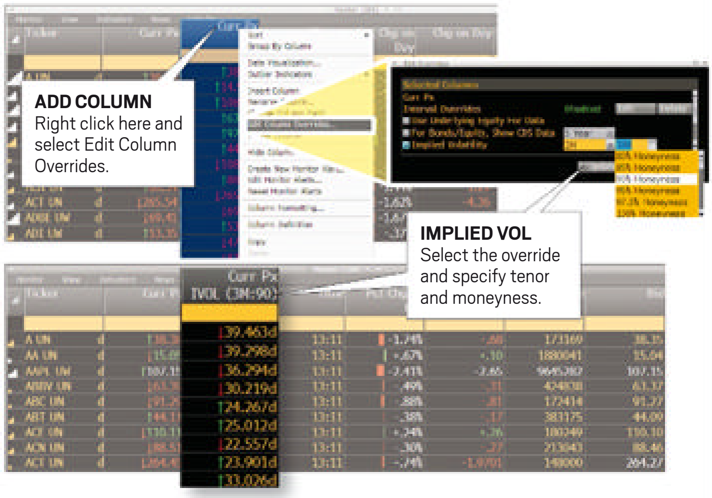
TIP BOX

Type **SDR FX <Go>** to track trade data for FX derivatives.

Christopher Weiss is an FX application specialist at Bloomberg in New York. cweiss29@bloomberg.net

Q: How can I track implied volatility for the stocks in a monitor?

A: The Launchpad Monitor was recently enhanced to make it easy to display that data. Type **BLP <Go>** to start Launchpad. Select the monitor in which you want to display the volatility data. Let's add the data in a new column. To create one, right click on a column heading and select Insert Column in the menu that appears. In the field at the top of the new column, enter *PRICE* and click on the Current Price With Arrows item in the list of matches. Next, right click on the Curr Px column heading in the new column and select Edit Column Overrides. In the Edit Overrides window that appears, click on the box to the left of Implied Volatility so that a check mark appears. You can specify the tenor and moneyness in the fields to the right. For example, to show three-month implied volatility at 90 percent moneyness, click on the arrow to the right of 1M and select Three Month Tenor. Click on the arrow to the right of 100 and select 90% Moneyness. Click on Update. Moneyness is a gauge of how close the strike price is to the trading price of the underlying stock.



USEFUL FUNCTIONS FOR TRACKING VOLATILITY

VCA <Go> analyzes volatility across a range of underlying assets.
MOSO <Go> displays the most-active options.
OVI <Go> tracks the largest options volume increases.
GV <Go> lets you compare vols for selected underlying securities.

LONG/SHORT PORTFOLIO VALUES

Bloomberg's suite of portfolio functions was recently enhanced to enable long/short equity managers to specify how their portfolio values are calculated in PORT. For more information, type **NSN NHPLOT6VDKHS <Go>** and click on the attachment.

MAPPING DATA STATE BY STATE

The Bloomberg Economic Evaluation of States function was recently enhanced to let you analyze a range of economic data across the U.S. states. Type **BEES <Go>**. To map changes in tax revenue, for example, click on the arrow to the right of Data, select Tax Revenue and press <Go>.

NORMAL VOLATILITIES FOR STIR FUTURES

Bloomberg is now calculating normal volatilities for short-term-interest-rate futures. To display normal volatilities for Eurodollar futures in the Option Monitor (OMON) function, for example, type **EDA <Comdty> OMON <Go>**. Click on the Actions button on the red tool bar and select Edit Template Settings. At the bottom of the window that appears, click on the circle to the left of Normal to select it as the STIR Calculation Model. Click on update. For more information on the calculation, type **DOCS #2072851 <Go>** and click on the PDF link.

Compiled by
JON ASMUNDSSON
jasmundsson@bloomberg.net

TIP BOX
For more recent enhancements, type **NEW <Go>**.

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